No. 2524

United States
Circuit Court of Appeals
For the Ninth Circuit

IDAHO-OREGON LIGHT AND POWER COMPANY, IDAHO RAILWAY, LIGHT & POWER COMPANY and O. G. F. MARKHUS, as Receiver of IDAHO RAILWAY, LIGHT & POWER COMPANY,
Appellants,

vs.

STATE BANK OF CHICAGO, BANKERS TRUST COMPANY, F. N. B. CLOSE, A. W. PRIEST, WILLIAM H. FORSTER, H. D. MILES, EDWARD J. MULLER, GEORGE E. FISHER, W. D. WILLARD, Personally and as a Bondholders Committee, W. J. FERRIS, as Receiver of IDAHO-OREGON LIGHT & POWER COMPANY, UNITED STATES OF AMERICA, IDAHO POWER & LIGHT COMPANY, GENERAL ELECTRIC COMPANY, WESTINGHOUSE ELECTRIC & MANUFACTURING COMPANY, A. H. SUNDLES and AMERICAN STEEL & WIRE COMPANY,
Appellees.

A. W. PRIEST, W. D. WILLARD, WM. H. FORSTER, H. D. MILES, EDWARD J. MULLER, GEORGE E. FISHER, D. M. LORD, JOHN R. ALLEN, W. O. CARRIER, ALLEN HOLLIS, CHARLES L. PARMELEE and CHARLES M. SMITH, Interveners, and Being a Protective Committee for the Holders of the First and Refunding Bonds of the IDAHO-OREGON LIGHT & POWER COMPANY,
Cross-Appellants,

vs.

IDAHO RAILWAY, LIGHT & POWER COMPANY, O. G. F. MARKHUS, Receiver of IDAHO RAILWAY, LIGHT & POWER COMPANY, IDAHO-OREGON LIGHT & POWER COMPANY and W. J. FERRIS, Its Receiver, BANKERS TRUST COMPANY, F. N. B. CLOSE, UNITED STATES OF AMERICA, IDAHO POWER & LIGHT COMPANY, GENERAL ELECTRIC COMPANY, WESTINGHOUSE ELECTRIC AND MANUFACTURING COMPANY, A. H. SUNDLES and AMERICAN STEEL & WIRE COMPANY,
Cross-Appellees.

BRIEF OF APPELLEES AND CROSS APPELLANTS

A. W. PRIEST, et al, BONDHOLDERS PROTECTIVE COMMITTEE

Upon Appeal From the United States District Court for the District of Idaho, Southern Division.

JOSEPH CUMMINS, Chicago, Illinois
RICHARDS & HAGA, Boise, Idaho,
Solicitors for A. W. Priest, et al.

SYMS-YORK CO., PRINTERS & BINDERS, BOISE

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INDEX

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Upon Appeal From the United States District Court for the District of Idaho, Southern Division.

STATEMENT OF THE CASE.

Idaho-Oregon Light and Power Company, a corporation, was organized in the State of Maine in 1907, the promoters and principal stockholders being William and Sinclair Mainland of Oshkosh, Wisconsin, who were engaged in the business of operating public utilities. The company acquired the properties of several smaller concerns operating in southwestern Idaho and eastern Oregon, and serving with electricity for lighting and commercial, mining and irrigating power the cities and towns of Boise,

South Boise, Emmett, Meridian, Payette, New Plymouth, Middleton, Parma, Star, and Weiser, Idaho, and Ontario, Huntington, Nyssa and Gypsum, Oregon, together with agricultural and mining districts included in the same territory. It also operates the water works supplying the village of Ontario, Oregon.

Upon its organization, it executed its deed of trust to the State Bank of Chicago, as trustee, conveying all property then owned and to be thereafter acquired, to secure the payment of bonds to a total authorized issue of seven million ($7,000,000) dollars, each bond having a denomination of one thousand ($1,000) dollars. The interest thereon was payable on April first and October first of each year. Five hundred thousand dollars ($500,000) of these bonds, bearing interest at the rate of six per cent. (6%) were immediately certified and delivered to the corporation, the proceeds thereof to be used for its general corporate business. An additional two million dollars ($2,000,000) of the bonds, also bearing interest at six per cent (6%) were to be certified from time to time as required, and the proceeds used to construct a power plant at what is known as the Ox Bow Bend of the Snake River, about fifty (50) miles below the City of Huntington, Oregon. Other issues under the mortgage were to bear five per cent. (5%) interest and were authorized to be issued to an amount not exceeding ninety (90%) per cent. of the cost of additions to the property.

With the property originally acquired by the Idaho-Oregon Light and Power Company (which will hereafter, for convenience, be referred to as the Power Company, or the Idaho-Oregon) it obtained a power plant on the Payette River known as the Horse Shoe Bend plant, situate about twenty-five (25) miles straight north of Boise, with an installed capacity of fifteen hundred (1500) kilowatts, and a long term lease on what is known as the Barber plant, belonging to the Barber Lumber Company, and situated on the Boise River about five (5) miles from the city of Boise, and having an installed capacity of nine hundred (900) kilowatts.

The capacity of these plants was sufficient for the needs of the territory served at the time of the organization of the company and for several years thereafter. It was, however, foreseen that the growth of the territory would shortly exceed the capacity of these plants and the construction of the Ox Bow plant was contemplated from the beginning and work thereon was begun in the year 1907. This was a very ambitious project, including a tunnel about eleven hundred (1100) feet in length across the neck of the Ox Bow bend, a dam fifty (50) feet in height across the Snake River, which, at this point, is a wide, deep and rapidly flowing stream, carrying a very large volume of water at all times of the year, and a power plant with an ultimate installed capacity of not less than thirty thousand (30,000) horse power.

The anticipated rapid growth of population and business in the territory served was realized, and the gross and net receipts of the company for the years 1907 to 1912, both inclusive, were as follows:

Year	Gross Earnings	Operating Expenses	Net Earnings
1907	$189,045.89	$ 98,586.48	$ 90,459.41
1908	196,416.16	83,438.80	112,977.36
1909	215,579.57	73,531.31	142,048.26
1910	247,041.43	82,526.01	214,515.42
1911	361,297.47	128,399.62	232,897.85
1912	405,210.21	189,318.10	215,892.11

The demand of its customers reached, and began to exceed, the capacity of the Horse Shoe Bend and Barber plants in the year 1911, when some power was purchased from the Swan Falls plant on the Snake River, which up to the latter part of 1911 was owned by the Trade Dollar Mining Company and which had a transmission line extending to, or near the city of Boise, where it served the Boise and Interurban Railroad, extending from Boise to Caldwell, and owned by the same interests that owned the Swan Falls plant.

The construction of the Ox Bow plant had, in the mean time, been prosecuted, but had not been completed. By the year 1910 the two million ($2,000,000) dollars allotted for that purpose, under the trust deed to the State Bank, had been exhausted and it was held that no further funds were available under the terms of that mortgage for the purpose of constructing the Ox Bow, and in the fall of

1910 a second deed of trust was given to secure the issue of bonds to the amount of ten million dollars, ($10,000,000), the proceeds to be used so far as necessary for refunding the bonds issued under the mortgage to the State Bank, and to provide additional funds for the corporate purposes, particularly to complete the construction of the Ox Bow plant. This is the mortgage to the Bankers' Trust Company and F. N. B. Close, named in the title of this cause as appellees.

In the spring or early summer of 1911 the Mainlands opened negotiations with Kissel Kinnicutt and Company, bankers and brokers of New York City, for the sale to them of a large block of the bonds secured by the second mortgage, and, under date of the 19th day of September, 1911, a contract was entered into (Trans. 168-193) between Kissel Kinnicutt and Company, Idaho-Oregon Light and Power Company and William and Sinclair Mainland, of which the principal provisions were the following:

1. Kissel Kinnicutt and Company, styled "The Bankers," should purchase of the Idaho-Oregon Company the second mortgage bonds to the par value of one million five hundred thousand ($1,500,000) dollars at eighty (80%) per cent. of their par value.

2. That the Bankers should receive as a bonus *upon completing* the purchase of said one million five hundred thousand ($1,500,000) dollars worth of bonds, one million seven hundred and thirty-six ($1,736,000) dollars par value of full paid and non-assessable preferred stock of the Power Company

entitled to seven (7%) per cent. cumulative dividends and two million three hundred and seventy-one ($2,371,000) dollars par value of full paid non-assessable common stock of the Power Company, being a total of four million one hundred and seven thousand ($4,107,000) dollars par value of stock out of a total authorized issue of ten million ($10,000,000) dollars, of which two million five hundred and sixty-one thousand nine hundred and sixty ($2,561,960) dollars was outstanding in the hands of the general public.

3. The agreed effect as to stock holdings was that after the issue of the said stock to the Bankers, the Bankers and the Mainlands were to have substantially equal holdings.

4. The Board of Directors of the Power Company was to be increased from five to eleven; the Bankers were to nominate five, the Mainlands five, and the eleventh was to be mutually agreed upon. There was to be an executive committee of five of whom the Bankers were to nominate two, the Mainlands two, and the fifth was to be mutually agreed upon.

5. The Bankers were to have an option on all the rest of the authorized ten million ($10,000,000) dollars of bonds under the second mortgage at the same price, namely eighty (80%) per cent of the par value.

6. The bonds under the first mortgage to the State Bank were callable at one hundred and five

(105) and the Bankers had the right to enforce the refunding provisions by requiring the Power Company to call bonds under the first mortgage and to sell to the Bankers at eighty (80) bonds under the second mortgage with which to obtain the funds to call the bonds under the first mortgage.

7. The Power Company was required to purchase of the Bankers any or all of the prior lien bonds (which included not only $2,494,000 of bonds outstanding under the mortgage to the State Bank, but $535,000 of underlying divisional bonds which were on separate portions of the property when acquired by the Idaho-Oregon Company) at the call price whenever requested thereto by the Bankers.

8. Trustees selected by the Bankers were to be substituted for the trustees then holding, in the various trust deeds.

9. The purchase of the Swan Falls plant was contemplated and a new corporation was to be organized as a holding company which would take over the Swan Falls plant and such other property as might be purchased and into which should be merged the Idaho-Oregon Company, either by acquiring its stock or by acquiring its property outright by conveyance.

10. The Bankers had the option to purchase any or all of the bonds of the holding company at eighty (80) and have the right to require the new company to purchase from the Bankers any or all of the

prior lien bonds of the Idaho-Oregon Company at the call price.

11. The Bankers reserved the right to reverse the operation and if they saw fit not to organize the new company, had the right to require the Idaho-Oregon Company to take the Swan Falls property, or whatever property they should acquire, off their hands, paying the Bankers therefor with Idaho-Oregon bonds at eighty (80).

Several of these provisions are not directly involved in the later history of this case but a knowledge of them will be useful in the discussion which is to follow.

In making this contract Kissel Kinnicutt and Company were not in fact acting for that firm alone but were acting for a syndicate which Mr. Fuller (of Kissel Kinnicutt and Company) testified was composed of a large number of persons and corporations, the principal members being Kissel Kinnicutt and Company, Winslow, Lanier and Company, the Guaranty Trust Company, the Chase National Bank, and the Bankers' Trust Company, all of New York City. This group will be hereinafter referred to as the "Railway Syndicate."

Within the next few months the things contemplated by the contract of September 19th, 1911, were put into effect with some modifications and additions. The corporation now known as the Idaho Railway Light and Power Company was organized under the laws of the State of Maine, as the holding company, with an authorized capital of thirty mil-

lion ($30,000,000) dollars, consisting of both common and preferred stock, and an authorized bond issue of thirty million ($30,000,000) dollars and a deed of trust was given to the Guaranty Trust Company of New York to secure the proposed bond issue. Not only was the Swan Falls plant and its transmission lines to Boise acquired but there were acquired also the Boise and Interurban Railroad, extending from Boise to Caldwell, the Boise Valley Railroad, extending from Boise to Nampa, the Boise Railroad, owning the local street railway system in the City of Boise, the distributing plants in the Cities of Nampa and Caldwell, and about eight (8) miles of electric railroad were built between Nampa and Caldwell to connect the two interurban lines so as to complete a loop.

A general offer to exchange common and preferred stock of the Railway Company for common and preferred stock of the Idaho-Oregon Company was made and such exchanges effected, including the Idaho-Oregon stock held by the Mainlands, so that about ninety-eight (98%) per cent of all the outstanding stock of the Idaho-Oregon Company came into the possession of the Railway Company.

A board of eleven (11) directors was elected by the Railway Company, consisting of the following persons for the Bankers: Albert H. Wiggin, President of the Chase National Bank; S. L. Fuller, of Kissel Kinnicutt and Company; Stacey C. Richmond, of Winslow Lanier and Company; John D. Ryan, President of the Montana Power Company; and

Charles H. Sabin, Vice-President of the Guaranty Trust Company; and the following persons representing the Mainlands and other interests in the Power Company: William Mainland and Sinclair Mainland, of Oshkosh, Wisconsin; Grant Fitch, of Milwaukee, Wisconsin; Ralph M. Burtis of Chicago, and A. E. Thompson of Oshkosh, Wisconsin. For the eleventh director there was elected Mr. Robert W. Watson, who was suggested by Mr. Fuller, and who was in some way associated with Mr. Fuller. The executive committee of five (5) was composed of Mr. Fuller and Mr. Wiggin, the two Mainlands, and Mr. Watson.

The property continued under the management of the Mainlands until some time early in 1912, when the position of "Managing Director" was created and Mr. Watson appointed thereto and Mr. Watson was put in substantially entire charge of the management of all properties.

The Railway Company, exercising its power as the holder of substantially all of the stock of the Idaho-Oregon Company elected its entire Board of Directors to be the directors of the Idaho-Oregon Company. Mr. William Mainland was made President of both companies and Mr. G. E. Hendee, who was private secretary to Mr. Fuller, was made Secretary and Treasurer of both companies.

By December, 1912, the Railway Company had outstanding (Trans. 208) more than $12,000,000 of common stock, $3,500,000 of preferred stock, $6,000,000 of its own first mortgage bonds, nearly $1,-

500,000 of underlying bonds on properties acquired other than the Idaho-Oregon, and about $362,000 of current floating indebtedness, or a total interest bearing obligation of more than $7,500,000 on which the fixed charges were more than $375,000 per annum. Their operating report for the twelve months ending December, 1912, showed the sum available for fixed charges to be $246,139.74. In this, however, was included $44,898.43 of non-operating revenue which was in fact composed almost wholly of interest on the second mortgage bonds of the Idaho-Oregon Company, which subsequent events brought about by the Railway Company, wholly eliminated, leaving about $200,000 ostensibly available with which to pay fixed charges of $375,000.00. This $200,000.00 however included uncollected and uncollectible items to a substantial amount so that the actual income available to meet these fixed charges was less than $200,000.00.

On September 25th, 1912, a meeting of the Directors of the Idaho-Oregon Company was held in the Chase National Bank, New York City. (Trans. 233). The call for the meeting gave no notice of the character of the business to be transacted. Of the five western members three only were present. These were the two Mainlands, who were the President and Vice-President respectively of the company and Mr. Thompson, of Oshkosh, who was the personal counsel of the Mainlands and had been and still was in some matters the counsel of the company. They had no information prior to the meet-

ing of the program which was presented (Trans. 302, 309 and 319). In addition to the three persons mentioned, there were present (Trans. 333) Messrs. Wiggin, Sabin, Fuller, Watson and Richmond. Mr. William Mainland acted as chairman of the meeting and Hendee is said by the minutes to have acted as secretary though he did not so act in fact. The business was transacted by Mr. Wickes, the company's New York counsel (who was also the private counsel for Mr. Fuller) who presented and read a previously prepared draft of minutes which included proposed contracts, notes, resolutions and results of the votes on the resolutions (Thompson deposition, Trans. 289 et seq). There was a proposed agreement between Kissel, Kinnicutt and Company and the Idaho-Oregon Company and William and Sinclair Mainland (Trans. 236-241) to the following effect:

1. The Company released the Bankers from their agreement of September 19, 1911 to purchase $1,500,000.00 of second mortgage bonds, the Bankers having up to that time taken $1,325,000.00 and the contract being unfulfilled as to $175,000.00 which, if fulfilled, would give the company an additional $140,000.00 in cash.

2. The Bankers were to "procure" the Railway Company to loan to the Idaho-Oregon Company $250,000.00, taking its notes at six (6%) per cent., secured by the pledge of Idaho-Oregon first mortgage bonds to the par value of $500,000.00.

3. The Idaho-Oregon Company was to receive back from the Railway Company which now held them second mortgage bonds of those purchased by the Bankers up to the amount of $500,000.00 and give in place thereof first mortgage bonds out of its treasury, of the same par value.

Although William and Sinclair Mainland were to be parties to this proposed agreement they both testified that they had not been consulted with reference to this proposal and had heard nothing of it until they went into the meeting. (Trans. 317, 319).

The record says that a resolution to enter into the said arrangement "was unanimously adopted with the exception of Mr. Fuller's and Mr. Sinclair Mainland's votes, which were not cast." Mr. William Mainland, Mr. Sinclair Mainland and Mr. A. E. Thompson all testified (Trans. 309, 319, 293) that Mr. Thompson voted in the negative, Mr. Sinclair Mainland voted in the negative, and Mr. William Mainland did not vote.

There was then presented a proposal from the Railway Company to advance $250,000 upon the notes of the Idaho-Oregon Company with first mortgage bonds as collateral, with the further provision that the Idaho-Oregon Company would exchange with the Railway Company, dollar for dollar and bond for bond, not to exceed $500,000 of Idaho-Oregon first mortgage bonds for Idaho-Oregon second mortgage bonds then held by the Railway Company.

The meeting then proceeded to take action with the view to obtaining from the State Bank, Trustee

under the first mortgage, the certification of additional first mortgage bonds to be used in the proposed exchange.

After the beginning of the foreclosure proceedings, of which this litigation is a part, and after the intervention of the appellees in said foreclosure proceedings, the depositions of Mr. Wiggin, Mr. Sabin, Mr. Richmond, Mr. Fuller and Mr. Watson were all taken at New York in November, 1913, (Trans. 273-279, 283-289). None of the witnesses had any recollection as to what especially was to be done with the $250,000. They recalled no program looking to the permanence and stability of the enterprise that was to be carried out with the money thus obtained and could recall no reasons for the action then taken except that, as they understood it, the company was in need of money. Mr. Watson, the Managing Director, said the company was being pressed for money but, as he remembered it, nothing particular stood out. (Trans. 273). The other witnesses recalled that the transaction was recommended by the Managing Director, but did not recall any special reasons advanced in favor of it.

The money was actually advanced to the Idaho-Oregon Company as follows:

October 4, 1912	$100,000.00
November 1, 1912	20,000.00
December 11, 1912	60,000.00
December 17, 1912	40,000.00
January 3, 1913	30,000.00

On the 27th day of September, 1912, two days later, there was held at the office of Kissel, Kinnicutt and Company, 14 Wall Street, New York City, a meeting of the executive committee of the Idaho-Oregon Company, at which there were present the two Mainlands, Watson and Fuller. There was adopted and authorized a proposed agreement (Trans. 251-256) to be entered into between Kissel, Kinnicutt and Company, the Idaho-Oregon Company, the Mainlands and the Railway, which, after reciting certain features of the contract of September 19, 1911, mutually released and discharged the various obligations of the contract referred to as the "Syndicate Contract", except as they were expressly, or by reference, continued in force, continued the option to the Bankers to purchase Idaho-Oregon second mortgage bonds at eighty (80), assigned the said option to the Railway Company, released the Bankers from taking the remaining $175,000, substituted the Railway Company for the Bankers in the covenants respecting the taking up of prior lien bonds, and gave the Railway Company the right to take first mortgage bonds instead of seconds, at its election.

The interest on the first mortgage bonds due October 1, 1912, was paid. The interest on the second mortgage bonds was due November first. No exchanges were made prior to that time and this interest was collected by the Railway Company.

The corporate records containing the minutes of the meetings of the directors and executive commit-

tee of the Idaho-Oregon are found in a loose leaf book which was in charge of Mr. Hendee, the secretary. In this book are certain typewritten sheets containing the alleged record of a meeting of the executive committee of the Idaho-Oregon Company held in the Chase National Bank, December 27, 1912, at which, according to the alleged record (Trans. 400-413), all the members of the executive committee were present, which recites that Mr. William Mainland acted as chairman and Mr. Sinclair Mainland as secretary. The minutes are not signed. Mr. Sinclair Mainland testifies (Trans. 320) that he did not recall ever having seen the record of that meeting until the day before his testimony was taken in this cause, in May, 1914, and that he first learned of the agreement for the further exchange of bonds in connection with the Bates and Rogers settlement only a day or two prior to the taking of his deposition. He did not recall having had any information as to additional bonds having been traded or put out as stated in these minutes. Mr. Forsyth Wickes, attorney in New York City, for the Idaho-Oregon Company under the Fuller-Watson management testified (Trans. 424) that he wrote up the minutes of the meeting of December 27th and that he had no specific recollection whether he sent out those minutes to the members of the executive committee or to the alleged secretary, Mr. Sinclair Mainland, or not, and that he did not remember that anybody but himself kept notes of the minutes of the meeting of December 27th.

The alleged record of December 27th was admitted over the objection of the appellees.

According to this record, (Trans. 400), a certain settlement was made between the Idaho-Oregon and Bates and Rogers Construction Company, which had been doing some work at the Ox Bow, and as a part of said settlement Bates and Rogers accepted twenty-five thousand dollars ($25,000) of the second mortgage bonds of the Idaho-Oregon at 80 in payment of twenty thousand dollars ($20,000) of their claim, the payment of the said bonds being guaranteed by the Railway Company. In addition thereto the Railway Company was to give to Bates and Rogers one hundred (100) shares of its common stock and fifty (50) shares of its preferred stock, the shares having a par value of one hundred ($100) dollars.

In consideration of this guaranty and the delivery of the stock (upon which no stated value seems to have been placed in the transaction) the Idaho-Oregon agreed to make a further exchange of first mortgage bonds in its treasury, or to be thereafter certified, for its second mortgage bonds held by the Railway Company up to the par value of $500,000, making a total authorized exchange of bonds having a par value of $1,000,000.

Mr. William Mainland testifies that he had conducted a part of the negotiations with Bates and Rogers for a settlement with them and had arranged such a settlement, that Rogers was willing to take the Power Company's first mortgage bonds at the market price (Trans. 314) but absolutely refused to

take the consolidated bonds without a guaranty; that he discussed the matter with Fuller and Fuller refused to give Bates and Rogers first mortgage bonds but was willing to give them the seconds and the Railway guaranty, but that nothing was said between himself and Fuller about the Railway Company getting a further exchange of bonds as compensation for the guaranty. The witness had no recollection of such action having been taken at the meeting of December 27th, as appears in the alleged record of that meeting. (Trans. 314).

A part only of the first mortgage bonds proposed to be exchanged were at the time certified or in the treasury of the company, but certifications were obtained from the trustee, the State Bank, from time to time until a total of seven hundred and eighteen (718) bonds had been made available and all of these bonds were exchanged under these agreements, subsequent to January 1, 1913. The company was demanding further certifications of first mortgage bonds and the trustee, the State Bank, did certify an additional one hundred and seven (107) bonds on or about the 10th day of April, 1913 after default had been made in the payment of interest on the issue. Four days later an agreement was made pledging these 107 bonds as collateral and they also were delivered to the Railway Company under that pledge.

For the sake of the connection, reference is here made to the fact that, as it appears from disconnected portions of the record, the Railway Company was insolvent, was placed in the hands of a receiver

on December 23, 1913, that its property will not meet the claims of its first mortgage bond holders; that the claim of Bates and Rogers on the guaranty can not therefore be in fact enforced, and that the stock given as a part of the transaction of December 27, 1912, is worthless.

On February 24, 1913, a meeting of the directors of the Idaho-Oregon Company was held at the Chase National Bank, New York City. (Trans. 349). There were present Messrs. Wiggin, Fuller, Watson, Sabin, Ryan and Sinclair Mainland. At this meeting Mr. Sabin, Mr. Wiggin, Mr. Fuller, Mr. Ryan and Mr. Richmond resigned as directors of the Idaho-Oregon Company and Mr. Hendee, Judson H. Morey, Edward J. Wolff, Milton H. Greenwalt, and John James McGirl were elected their successors. Mr. Sabin was the Vice-President of the Guaranty Trust Company of New York, Mr. Hendee elected as his successor, was Mr. Fuller's private secretary; Mr. Wiggin was President of the Chase National Bank, Mr. Morey, his successor, was an employee of Winslow, Lanier and Company; Mr. Fuller was a partner of Kissel, Kinnicutt and Company, his successor, Mr. Wolff was a bookkeeper of Kissel, Kinnicutt and Company; Mr. Richmond was a partner in Winslow, Lanier and Company, his successor was an auditor in the office of Watson, the Managing Director; Mr. Ryan was president of the Amalgamated Copper Company and a director in several banks, Mr. McGirl, his successor was an employee of Winslow, Lanier and Company.

On April 1, 1913, the Idaho-Oregon Company defaulted in the payment of the semi-annual interest on its first mortgage bonds due that day. Under date of March 26th, a circular letter went out to all the bondholders (Trans. 80-89) under the names of Charles E. Bockus, of the Old Colony Trust Company of Boston, L. B. Franklin, of the Guaranty Trust Company of New York, Samuel L. Fuller, of Kissel, Kinnicutt Company of New York, William Mainland of Oshkosh, Wisconsin, Homer W. McCoy of McCoy and Company, brokers, Chicago, Daniel E. Pomeroy, of the Bankers Trust Company of New York and Stacey C. Richmond of Winslow, Lanier Company of New York, as a committee, accompanied by a deposit agreement signed by the same persons as a bondholders protective committee. The agreement provided for the deposit with the persons named, as a protective committee, of the first mortgage bonds of the Idaho-Oregon Light and Power Company, with the usual plenary powers granted to such committees, and set forth a plan of re-organization whereby all the property of the Idaho-Oregon Company was to be acquired by the Railway Company subject only to certain underlying divisional bonds then amounting to $534,000.00 and to give to the holders of the $2,494,000.00 of Idaho-Oregon first mortgage bonds in the hands of the public five per cent (5%) bonds of the Railway Company secured by what was termed an adjustment mortgage, the interest thereon to be paid only as earned and to be non-cumulative. This mortgage was subject to

all the underlying divisional mortgages of the Railway Company and to its general first mortgage above referred to. The amount of Railway first mortgage bonds to which the adjustment mortgage was subject was stated to be $4,500,000.00 "when acquired" but the Railway Company's first mortgage was, in fact an open mortgage with an authorized issue of $30,000,000.00 and it was not proposed to be closed.

The deposit agreement (Trans. 65) recited that it was "understood" that the earnings of the Power Company during the previous six months were not sufficient to pay the coupons on the first mortgage bonds about to mature April 1, 1913, and that (Trans. 66) "*in order to avoid a foreclosure* of the mortgage securing said bonds and to procure additional capital for the Power Company the following plan has been evolved for the adjustment of the finances of the Power Company". The circular accompanying the plan (Trans. 80) declared that the Railway Company owned $718,000.00 of the Power Company's first mortgage bonds, $854,000.00 of its second mortgage bonds, $250,000.00 of its notes and nearly all of its stock and that on account of its large holdings of the Power Company's securities and its dominant position as the owner of large consumers of power in the territory served by the Power Company, the co-operation of the Railway Company was essential to the success of any plan for the readjustment of the affairs of the Power Company.

The circular further stated that the signers above named had been "designated as a protective committee" to carry out said plan and they invited the deposit of the Idaho-Oregon first mortgage bonds under the terms thereof.

Some weeks went by and comparatively few of the Idaho-Oregon first mortgage bonds had been deposited with this committee, whereupon various brokers and bond dealers who had been concerned in the sale of the Idaho-Oregon bonds in former years before the advent of the New York syndicate in its affairs, were invited to New York for a conference and remained in New York for two weeks, having their expenses paid, and numerous conferences were held with Mr. Fuller and the committee's counsel, Mr. Eldon Bisbee, with the result that a modification of the plan was framed and initialed by the persons attending the conference. The testimony of Mr. Fuller on this subject (Trans. 466-475) was refused admission by the trial court and is found in the supplemental statement of evidence by the cross-appellees. This modification was only to the effect that the adjustment bonds to be given to the Idaho-Oregon bond holders instead of being a non-cumulative income bond should have a fixed rate of interest beginning at two per cent (2%) and gradually advancing to five per cent (5%). These brokers, who had been in correspondence with their customers, respecting the situation, then, for the most part, advised their customers to deposit their bonds with the New York committee.

Mr. Fuller testified, upon cross-examination in this cause, (Trans. 475) that he agreed to pay, and did pay commissions to several of the brokers for obtaining the deposit of bonds of their customers with the New York committee.

By the first of June, 1913, the New York committee had on deposit more than two-thirds, of the bonds (counting the 718 exchanged bonds as a part of the bonds on deposit) and instituted proceedings, under the terms of the trust deed, by making a written request of the trustee as the holder of more than two-thirds of the bonds (Trans. 375) to begin foreclosure proceedings, although the preamble of the deposit agreement recites that the plan proposed to avoid foreclosure. The bill to foreclose was filed in the District Court of the United States for the Southern District of Idaho, by the State Bank of Chicago, as complainant, on July 7, 1913. The return day of the summons was August 11, 1913, and on that day a decree was presented, accompanied by evidence taken by deposition prior to the return day. On August 14th the interveners filed their petition for leave to intervene, in support of the bill. On August 20th a decree of foreclosure and sale was entered against the objection of the interveners, the Court, however, specially reserving the power and authority to permit intervention and to make such modifications in the decree as justice might require.

On the 30th day of August, 1913, the appellees, constituting a Bondholders' Committee which had been organized at Chicago for the purpose of protecting the interests of the bondholders in the premises filed a further petition for leave to intervene and their intervention was vigorously opposed by the trustee and the Idaho-Oregon Company. After some preliminary efforts on the part of interveners, the matter was set for September 15th, 1913, and after a hearing in open court lasting several days the court entered an order on September 19th (Abst. 55) permitting the appellees to intervene for certain specified purposes expressed as follows: (Trans. 56) "2. That the complainant and the defendant Idaho-Oregon Light and Power Company are required to answer all of the allegations in said Bill in Intervention relating to the 718 bonds, aggregating $718,000.00 par value, secured by the first and refunding mortgage upon which foreclosure is sought here, which bonds are alleged to have been obtained by the Railway Company in exchange for so-called consolidated or second mortgage bonds, and that the said defendant Power Company make full disclosures with reference to its transactions in, and dealings with, and the present location, ownership, and control of the 107 bonds certified after April 1, 1913, and also in like manner answer relative to the 520 first mortgage bonds included in the 2124 bonds referred to in paragraph XIV of the Bill of Intervention.

3. That the Idaho Railway Light and Power

Company be, and hereby is, made a party, for the purpose of answering the allegations of the said Bill in Intervention respecting the said 718 bonds, and that subpoena issue accordingly".

Subsequently by stipulation, issues relative to the 520 bonds were dismissed from further consideration and issues relative to the 107 bonds, except as to the propriety of their certification, were left to be tried in another proceeding, so that the issues tried in this proceeding related to the status of the 718 bonds and to the propriety of the certification of the 107 bonds.

The Bill in Intervention (Trans. 5) makes the following allegations, aside from the formal ones and matters already stated:

1. That the interveners own first mortgage bonds of the Idaho-Oregon Light & Power Company to the amount of $137,000.00; that there had been deposited with them as a bond holders committee, in addition thereto, bonds to the amount of $224,000.00 and that persons who had already deposited their bonds with the New York committee had deposited with the interveners their certificates issued by the depositaries of the New York committee representing bonds to the amount of $71,000.00 the total amount thus held and represented being $432,000.00 at the time of filing the bill.

2. That the Power Company was organized under the laws of the State of Maine in 1907, with an authorized capital of $7,500,000.00 afterwards in-

creased to $10,000,000.00 and that the persons principally concerned therein and who became its chief stockholders and its President, Secretary and members of its Board of Directors were William and Sinclair Mainland; that it proceeded to acquire the properties above described and to construct the power plant on the Ox Bow bend of the Snake River; that the company enjoyed a large and rapidly increasing gross and net income until and including the year 1911, and that it paid the interest on all of its outstanding indebtedness from time to time issued from 1907 until 1911 inclusive and that official audits showed a surplus above the requirements for operating expenses and interest, and that in the years 1908, 1909, 1910, the Power Company paid out of its surplus $91,152.17 in dividends upon its stock.

3. That in 1911 the company, for the purpose of obtaining additional money with which to complete the Ox Bow plant, entered into the contract with Kissel, Kinnicutt and Company, an inspection of which had been requested of the Power Company by the interveners and refused. (This is the contract above referred to).

4. The bill then describes the organization of the Railway Company, its acquisition of control of the Power Company and its acquisition of the various properties, to-wit: The Swan Falls plant, the traction properties, etc.

5. That prior to the acquisition of the said properties by the Railway Company, the Boise Valley Railroad was a customer of the Power Company and

that its business had been taken away from the Power Company and turned over to the Railway Company thus reducing the income of the Power Company and its ability to meet its obligations to the interveners and other bondholders; that the Boise Railroad, being the local street car system of the City of Boise, was under contract for a term of years to purchase its power of the Power Company, upon terms highly profitable and advantageous to the Power Company, and that immediately upon its acquisition by the Railway Company, the latter caused the contract to be cancelled and transferred the business to the Railway Company, thus again reducing the income and business of the Power Company; that in other ways the Railway Company was pursuing the policy of throttling the Power Company and absorbing its business.

6. That the Railway Company had issued $6,500,000.00 of bonds, all of which had been purchased or contracted to be purchased by Kissel, Kinnicutt and Company with the purpose of re-selling the same to the public; that the bonds had not in fact been sold, and had not been marketable for the reasons set forth in the bill; that Kissel, Kinnicutt and Company not being able to dispose of the bonds to the public had pledged the bonds to various banking institutions for securities for loans and that such bonds were held in large quantities by the Guaranty Trust Company of New York, the Bankers Trust Company of New York, the Chase National Bank of New York, Winslow, Lanier and Company of New York,

and the First National Bank of New York; that the reason why Kissel, Kinnicutt had not been able to dispose of the bonds to the public was that the property acquired by the Railway Company had not been profitable and was not earning sufficient to meet their operating charges, to make provision for depreciation and pay interest upon the excessive and exorbitant prices paid for the properties; that Kissel, Kinnicutt and Company and their associated banks had then been carrying this load for nearly two years and that it became clearly necessary to consummate the plan of acquiring the property of the Power Company in such a manner as to get additional security behind the bonds of the Railway Company, and especially to show added earning capacity, in order to render the Railway bonds marketable and avoid an enormous loss on the $6,500,000.00 of such bonds; that the readily available course was to get rid of the first mortgage bonds of the Power Company by the easy device of foreclosure, at which there would be, and could be no bidder except the Railway Company and thus seize the property and earnings of the Power Company.

7. That the purpose of the Power Company and the Mainlands in executing the second mortgage and in contracting for the sale of $1,500,000.00 of bonds thereunder to Kissel, Kinnicutt and Company was to obtain funds for completing the Ox Bow, which would have provided the Power Company with ample power and enabled it to largely increase its earnings; that Kissel, Kinnicutt and Company contrary

to the provisions of their agreement and in violation of the rights of the Power Company performed the same only in part, and being in control of the Power Company caused the latter, without consideration, to release them, the said Kissel, Kinnicutt and Company from the contract at a time when it was impossible to obtain funds from other sources; that although the purpose of the second mortgage and the sale of the $1,500,000.00 bonds secured thereby was to obtain funds to complete the Ox Bow plant, the money actually received by the Power Company from such bonds was not in fact applied to the completion of the Ox Bow plant but was, under the domination and control of the Railway Company, diverted to other purposes to the great injury of the Power Company and the interveners charge that this was done in pursuance of the scheme to reduce and divert the income of the Power Company, break down its credit, cause it to default, and to purchase its property for a nominal sum to the fraud and injury of the holders of the first mortgage bonds of the Power Company.

8. The interveners then showed that the Power Company showed a constantly increasing surplus each year from the organization of the company down to 1911, over its requirements for operating expenses, maintenance and bond interest until 1912, during which year it had been under the control of the Railway Company, when a surplus in 1911 of $146,532.52 was converted into a deficit in 1912 of $59,654.28 (Trans. 17); that the Railway Company

obtained complete domination and control of the Power Company in the latter part of 1911 and exercised that control for the first complete year during 1912; that in 1912 the operating expenses increased 55% over those of 1911 while there was an increase of only 11% in operating income; and that in 1911, during only a part of which the Railway Company had control, the commercial and general expenses were 130% more than they were in 1910, while the business increased only 20%; that the control and domination of the Railway Company over the Power Company is thus shown to have been destructive of its business and income and an attack upon the security of the bonds held by the interveners, and it is charged that such control and domination were exercised for the purpose of depreciating such securities and enabling the Railway Company to carry out the scheme of acquiring the Power Company's property; that the defaulting interest, the proposed re-organization and the suit to foreclose are all part of that scheme.

9. The bill then sets out the names and connections of the persons constituting the New York reorganization committee and shows that three members of the committee were representatives of banking concerns interested in the organization of the Railway Company and large holders of its stock and bonds either as pledgees or otherwise and not in any way interested in the first mortgage bonds of the Power Company; that a fourth, Fuller, was the chief promoter and controlling factor in the Railway Com-

pany, and a fifth was the President of the Railway Company; that no member of the committee, as the interveners were informed, and believed, with the possible exception of Fuller had any interest whatever in the first mortgage bonds of the Power Company, but that the committee was selected and appointed wholly by, and in the interests of the Railway Company and for the purpose of promoting and protecting those interests and not in any sense, manner, or degree in the interests of or for the protection of the holders of the first mortgage bonds of the Power Company and that the pretense that they were appointed by or acting on behalf of such bond holders or representing the interests of such bond holders was false and fraudulent and intended to deceive and mislead the bondholders and forestall any action by the bond holders in their own interests, which would otherwise have taken place after the occurrence of the default.

10. That subsequent to the putting out of the first plan and prior to putting out the modification of May 1, 1913, Fuller as chairman was requested, by addition, or substitution, to place on the said committee actual bond holders nominated or selected by the holders of the Power Company's first mortgage bonds and that Fuller refused such request; that the deposit of the Power Company's bonds with the New York Committee had thus been obtained by fraud, misrepresentation, and deceit, and that they were not as respects any proceedings in a court of equity entitled to be recognized as representing said bonds

and that the trustee, the complainant in the foreclosure, being now charged with full knowledge of the character and purpose of the said committee had no right to act at the instance or upon the demand and request of the said committee as representing the bonds so obtained by such misrepresentation, fraud and deceit.

11. The Bill then sets out the circular and plan of March 26th, 1913, the failure of the New York Committee to obtain the deposit of any considerable number of bonds, the visit of the brokers who had sold the Power Company's bonds to New York at the invitation of the New York Committee, the adoption of the revised plan of May 1, 1913, the advice of the brokers to their customers to deposit their bonds with the New York committee and the peculiar relation between the broker and his customer and the dependence by the customer upon the broker for information and advice in such a situation as was thus created.

12. The bill then sets out the organization of the committee of bondholders in Chicago, which will be referred to as the Priest Committee, the present appellees, that it was created primarily for the purpose of obtaining information as to the character, value and prospects of the Power Company's properties, the reason for the alleged default and the character, value, and prospects of the properties of the Railway Company upon which a second mortgage was offered them in exchange for their first mortgage on the property of the Power Company; that they sought

this information of the New York committee, the Power Company, of the Railway Company and of Kissel, Kinnicutt and Company, but for the most part such information was refused and denied; that they were refused the right to inspect the books of record of the Power Company, the books of record of the Railway Company, the names of the persons who were directors of the Power Company, the names of the persons who were directors of the Railway Company, the names and addresses of their fellow bondholders, with whom they desired to communicate for their mutual protection, the operating reports of the Railway Company, and the operating reports of the Power Company subsequent to January 1, 1913, all of which information was in the possession of one or more, or all, of the persons and corporations named, and should have been freely supplied to the bondholders in connection with the proposal of the New York committee.

13. That the exchange of $718,000.00 of first mortgage bonds by the Power Company for second mortgage bonds previously purchased and held by the Railway Company was without consideration, that the second mortgage bonds, in view of the default and foreclosure then planned and anticipated at the time of exchange had no market value and were to all intents and purposes worthless and the exchange was, as to the interveners and the Power Company, fraudulent and wrongful, and that the said $718,000.00 of bonds were not under the cir-

cumstances issued and outstanding and valid obligations of the Power Company.

14. That on or about the 10th of April, 1913, the Power Company, acting under the domination, authority and demand of the Railway Company, caused the Trustee to certify and deliver to it $107,000.00 of first mortgage bonds, being a part of the $3,319,-000.00 of bonds alleged by the Bill of Complaint in foreclosure to be outstanding; that at the time of such certification the bonds in question had already been dishonored by default in the payment of interest and that the certification of such bonds was improper and unauthorized; that although alleged by the bill to be outstanding and valid obligations of the Power Company, the said 107 bonds were not in fact so outstanding but had never been sold or passed into the hands of bona fide owners for value, and were not a part of any valid obligation under the trust deed.

15. That according to the allegations of the bill to foreclose, there were outstanding $1,770,000.00 of second mortgage bonds of the Power Company; that all but $166,000.00 of those had been issued since the Railway Company came into the control of the Power Company and that all except the said $166,000.00 were in the hands of Kissel, Kinnicutt and the Railway Company; that in spite of the enormous increase of indebtedness of the Company incurred ostensibly for the completion of the Ox Bow, very little had in fact been done upon the Ox Bow and that such expenditure as had been made was ineffective and wasteful, while during the same time

the Railway Company had spent large sums in developing and increasing the capacity of the Swan Falls plant, belonging to the Railway Company, and that Fuller, in stating reasons why the first mortgage bond holders of the Power Company should submit to the demands of the Railway Company as put forth by the New York Committee, had declared that if the bondholders did not submit to such plan, the plan of reorganization would be abandoned, the Swan Falls plant would be enlarged and the Railway Company could and would take away the business of the Power Company.

16. That the Ox Bow was a large project on account of which $2,000,000.00 of bonds had been issued prior to the contract with Kissel, Kinnicutt and Company; that it contemplated the creation of an enormous amount of power, amounting to thirty-five or forty thousand horse-power; that if the Ox Bow had been completed as planned and for which ample financial resources had been actually created, the present situation of the Power Company could not have been brought about and the interveners charged that the failure of the persons in control of the Power Company since 1911 to complete the Ox Bow project was deliberate and for the purpose of wrecking the Power Company and obtaining its property for a nominal sum; that Fuller, as chairman of the New York committee was attacking and seeking to depreciate in public estimate the Power Company's property although acting or pretending to act as the chairman of the committee for the pro-

tection of the bondholders, and while retaining possession and control of the first mortgage bonds deposited with him as a trustee for, and in protection of the interests of the owners thereof, he had openly and violently attacked the interests of those bondholders so as to depreciate the value of their securities and had used every means in his power to prevent the sale of the property at an adequate price.

17. That the property of the Power Company consisted of divers and scattered units, much of it portable and movable, and some of it shifting and changing in its character; that its business consisted in furnishing electric current for light and power in a large number of communities and to an extremely large number of individuals and corporations, that its income was derived wholly from the furnishing of such current; that a large share of its business was conducted in competitive territory where competitors could and did obtain the customers and supply their wants immediately, if the Power Company should for any reason fail or refuse to do so; that it was impossible for any person outside the Railway Company and the Power Company, which was under control of the Railway Company to know or determine without assistance of persons connected with those companies, what the property of the Power Company is, or of what it consisted, and that it was impossible for the court to determine, except by the appointment of a receiver and by the inspection, assembling and scheduling of the property by such receiver, to know what was to be sold under any de-

cree of foreclosure or sale, or as to what and where the property was which is to be delivered to any purchaser thereat; that if a decree of sale were entered and the property remained in the hands of the adverse interests then in possession thereof much of the property could be easily sequestered, concealed or disposed of, and the contracts upon which the business and income of the Power Company depended, and without which the Power Company itself was of small value, could be terminated, and abandoned, and their value lost and destroyed; and that it was absolutely impossible that there should be an identification, scheduling, valuation, inspection or exhibition to purchasers without first placing the property in the power and possession of the court through a receiver.

18. The concluding paragraph XIX of the Bill of Intervention is as follows (Trans. 39):

"The interveners respectfully show that by means of the premises, the Power Company has passed under the domination and control of the Railway Company, which is a competitor and whose interests are adverse to the interests of both the other stockholders and of the creditors of the Power Company; that under the domination and control of the Railway Company the Power Company has been and is being stripped of its business and income, and its expenses enormously and improperly increased for the express purpose of depreciating and finally sequestering the property of the Power Company constituting the security of these interveners and its other cred-

itors; that conspiring and contriving to bring about a foreclosure of the first mortgage upon the property of the Power Company, not for the purpose of protecting the interests of the creditors secured thereby but solely for the purpose of obtaining the property of the Power Company at a nominal price and adding it to the property of the Railway Company, and thus adding to the value of the securities held by the persons in control of the Railway Company, the alleged default of April 1st, 1913, was brought about; that this default, while actual as to these interveners and other bondholders not assenting to the plan of re-organization devised by the Railway Company for its purposes and profit, was nominal as to the bonds controlled by the Railway Company, and that as to such bonds the interest has actually been paid; that under the control and domination of the Railway Company an actual consolidation of the property of the Power Company with the property of the Railway Company has been, to all intents and purposes, effected, so that the same persons are executive officers, managers and superintendents of both properties, to the manifest injury of the Power Company and its creditors; that if a foreclosure and a sale of the properties of the Power Company be had at the present time and under the circumstances now existing, it will not result in the payment of the debts of the Power Company, but will result in the sacrifice of its property and in the loss of the security of its creditors, and will redound only to the benefit of the Railway Company, which has planned and now seeks

to carry out such foreclosure, and which intends, as shown by the said plan of re-organization, to be the only purchaser at such sale, and which openly boasts that nothing can be done with the property of the Power Company except by its consent and co-operation; that it is absolutely essential to the protection of the Power Company's property and its creditors that the property of the Power Company be forthwith segregated from the property of the Railway Company and removed from the domination and control of the Railway Company. That unless this court by appropriate action takes possession and control of the property of the Power Company and removes it from the adverse possession of the Railway Company, its value will inevitably be sacrificed and destroyed. That the persons now in control of the Power Company, to-wit: the Railway Company, Kissel, Kinnicutt and Company, and William and Sinclair Mainland, either directly or through their ownership of the stock and securities of the Railway Company, are largely indebted to the Power Company upon stock which has been improperly and fraudulently issued to them without consideration therefor, and that it is through such stock so improperly and fraudulently issued to them that they have obtained and exercise the control and domination over the Power Company above referred to. That if the Power Company can recover and be put in possession of the moneys lawfully due it for this stock, which, to the amount of millions of dollars, has been issued as fully paid for but actually without being

paid for at all, it will be enabled to meet all its just obligations and carry on its business successfully and profitably. That there has been, as above shown issued by several devices bonds of the Power Company to the amount in one case of $107,000.00, and in another case to $718,000.00 which are alleged to be valid and outstanding obligations of the Power Company, but which in fact are not such valid and outstanding obligations, which should be surrendered and cancelled and if so surrendered and cancelled would thereby greatly reduce the alleged obligations of the Power Company and the interest charges against its income. That to properly protect the interests of these interveners and other creditors of the Power Company, and to protect the true interests of the Power Company itself, an accounting should be had between the Power Company, and Kissel, Kinnicutt and Company, the Power Company and the Railway Company, and the Power Company and William and Sinclair Mainland, under the auspices and by the authority of the Court, and that this may be accomplished it is necessary that a Receiver of the Power Company be appointed to assert the rights of the Power Company against the persons and corporations named; that, as a matter of course, no one outside of the Railway Company can be found to bid at any sale of the Power Company's property, unless such bidder can have full information as to the location, character and quantity of such property, and an opportunity to fully inspect the same; that any such bidder must also have full information as

to the operating history and results of the property; that the property itself and all information regarding it is in the hands of the Railway Company, and that all avenues of information are closed; that even the representatives of the interveners who would wish to bid if any such sale were had, if necessary to protect their interests, have been refused the necessary information, and William Mainland, the President of both the Power Company and the Railroad Company, has refused to give the representatives of the interveners a letter of introduction to the local manager of the Power Company, authorizing him to show such representatives over the property, though requested thereto.

The Bill in Intervention (as amended) prays for the appointment of a Receiver, that the 718 bonds be declared illegal and void; and that the defendants be required to show in detail what disposition has been made of the 107 bonds.

The answer of the Railway Company:

1. Denied that the allegations of the bill entitled the interveners to any relief against the Railway Company and moved that the same be dismissed as to the Railway Company .

2. Denies that the consolidated bonds had no market value or were worthless, denies that the exchange was without consideration, and denies that such exchange was either as to the defendant, the Power Company, or the interveners, wrongful or fraudulent.

3. Says that the Power Company was on September 25, 1912, in need of $250,000.00 and that it applied to the Railway Company for a loan of that amount, that the Railway Company was the owner by purchase of the consolidated bonds of the par value of about $1,500,000.00, bearing interest at 6%; that the Power Company represented that it had in its treasury as free assets first mortgage bonds to the amount of $305,000 and was entitled under the terms of the trust deed to further issue first mortgage bonds in excess of $500,000.00; that the Railway Company agreed to make the loan of $250,000.00 if the Power Company would exchange $500,000.00 of its first for an equal amount of seconds held by the Railway Company, and at the same time pledge first mortgage bonds as collateral to an amount double that of the loan; that the Power Company thereupon procured the certification of the bonds to which it was entitled from the trustee and made exchange under the said agreement to the amount of $440,000.00, and that the first mortgage bonds being thus delivered to the Railway Company, second mortgage bonds were substituted as collateral for the loan.

4. Recites the settlement with Bates and Rogers Construction Company and the alleged agreement by the Power Company in consideration thereof to make a further exchange of $500,000.00 of first mortgage bonds for seconds.

5. That it loaned the $250,000.00 as provided and made the exchange of bonds as stated, and that it

claimed to own and did own the said $718,000.00 par value of first mortgage bonds and was entitled to participate in the distribution of the proceeds of any sale to the extent thereof.

6. Prayed that its ownership of the said bonds be confirmed and that the Bill in Intervention be dismissed as to it.

The answer of the Power Company is in greater detail but covers the same essential facts.

The claimant, the State Bank, answered with reference to the 107 bonds that being applied to for the certification of the said bonds, it employed H. M. Byllesby and Company of Chicago, Engineers, to examine and advise it respecting the existence of additions to the property and the propriety of the expenditures upon which the proposed issue of bonds was based and that it received the report of said engineers about the 10th of March, 1913, and that the same was considered until March 31st, on which date it was advised by its counsel that the Power Company seemed to be entitled to have certified and delivered to it the 107 bonds, and the same were certified accordingly, and delivered to the Power Company.

The theory of the appellees at the time of filing their bill of intervention, as clearly appears from the bill, was that at least as early as the 25th of September, 1912, the syndicate which owned and held all the Railway securities of every class and which through the Railway as a holding company, owned nearly all

the second mortgage bonds and practically all the stock of the Power Company, had determined to wreck the Power Company and through their control of the situation, buy its property without competition at a foreclosure sale, giving junior securities of the Railway Company in payment thereof and thus sequester the entire property and income of the Power Company for the benefit of the owners of the Railway securities and that the contract of September 25, 1912, the contract of December 27, 1912, the exchange of all the first mortgage bonds which could be gotten in to the treasury of the Power Company before the default and the pledge as collateral of the 107 bonds which could not be obtained until after the default, the creation, in advance of the anticipated default, of an alleged bondholders committee composed chiefly of the holders of the Railway securities who did not hold any of the bonds to be "protected", the plan of re-organization, and the foreclosure were all a part of the scheme; and much of the evidence taken by the interveners was intended to establish the existence of such a purpose and to show that in making the exchange of bonds the persons who were directors of both the Railway and the Power Companies were not acting in good faith and according to their best judgment as directors of the Power Company in conserving its interests but were considering the interests of the Railway Company only and seeking to obtain an advantage for it as a creditor.

The good faith of the transaction of September 25, 1912, wherein the Railway Company, which had

assumed all the rights and obligations of Kissel, Kinnicutt and Company under the contract of September 19, 1911, was released from its obligations to complete its purchase of second mortgage bonds, loaned $250,000.00 and was to receive $500,000.00 of first mortgage bonds in exchange for seconds, is to be judged in the light of the circumstances and therefore inquiry was made in the depositions of all the directors except Mr. Ryan who was not called, as to whether there was any definite and reasonably comprehensive plan with respect to the affairs of the company which could be carried out with $250,000.00 and which could not be carried out with $140,000.00 and which would provide for the solvency and stability of the company for at least some reasonable future time. No evidence of any such plan is found in any of the testimony. On the other hand there is an entire absence of any adequate reason for such radical and extraordinary proceedings, nor was there any advance notice given to the directors that any such action, constituting an entire departure from ordinary business procedure, was contemplated. The President of the company had not heard that any such action was contemplated until it was proposed in the meeting, yet the counsel for the company had the contracts and notes all drawn in advance and the minutes of the meeting completely written out (Trans. 291). Eight out of the 11 members of the Board were present. Three of these represented the western, or Mainland interests, and five represented the Railway interests. Of the five representing the

Railway interests all voted in favor of the proposition except Mr. Fuller who did not vote because he was a partner in the firm of Kissel, Kinnicutt and Company, contracting with the company. Of the three western members, two voted in the negative and one was presiding and did not vote. There were therefore four affirmative votes out of eight directors present and a total board of eleven.

Assuming that the company was in urgent need of another $110,000.00 in addition to the $140,000.00 which it had a right to demand from the Railway Company, was any other and manifestly better way open to it than the method adopted by the Board? It had in its treasury, or was entitled to have certified $825,000.00 of first mortgage bonds. William Mainland testified (Trans. 318) that in his opinion the first mortgage bonds could have been sold at a fair price to realize funds. Mr. Charles E. Ranstead testified (Trans. 323) that he was in the bond business in Chicago from 1908 to 1912, as a member of the firm of Charles M. Smith and Company, which firm purchased and sold a considerable number of bonds of the Idaho-Oregon Company during that period. He submitted a table (Trans. 324-326) showing their purchases and sales of Idaho-Oregon bonds, with the amount of the sale, the date and price, which shows that the 6% bonds were sold at wholesale to dealers as late as the 13th day of September 1912, at 94 3-4. He testified that the 5% bonds would be equally salable upon a normal price ratio.

Charles O. Reynolds testified (Trans. 332) that he was in the business of selling bonds in Chicago in the firm of W. G. Souders and Company; that during the year 1908 and in subsequent years he was a member of the firm of Beierlein and Reynolds in Chicago and had been actively engaged with that firm in the purchase and sale of Idaho-Oregon bonds. He produced a schedule (Trans 333-340) showing a large number of transactions, continuing down to October 1912. Sales during 1912 were at an average price of 97.42 and three sales were made to Kissel, Kinnicutt and Company in March and April 1912 at 97 1-2 and 98. The witness' table shows that their sales of Idaho-Oregon firsts during 1910 were at an average price of 98.83, during 1911 at an average price of 97 and during 1912 at an average price of 97.42. These were all in 6% bonds. He testified that he had one transaction with Kissel, Kinnicutt and Company in November 1912 in which they purchased 5% bonds at 80 for the joint account of themselves and Kissel, Kinnicutt and Company. Beierlein and Reynolds had a joint account with Kissel, Kinnicutt and Company for dealing in Idaho-Oregon bonds which ran from January to September, 1912, and included transactions aggregating approximately $30,000.00.

Charles L. Parmelee testified (Trans. 343) that he was a banker and member of the firm of White and Company, at 30 Pine Street, New York City, and was engaged in the purchase and sale of bonds and other securities and had bought and sold Idaho-

Oregon firsts and refunding bonds from 1910 to the Spring of 1913. He submitted a table showing the transactions of that firm in Idaho-Oregon bonds down to December, 1912. From September to December, inclusive, the price ranged from 95 1-2 to dealers to par to private investors.

Mr. Edward J. Muller testified (Trans. 348) that he was the treasurer of The Fuchs and Lang Manufacturing Company, 119 West 40th Street, New York, had been in business in New York for thirty years. He and other members of his firm were owners of first mortgage bonds of the Power Company and had personal knowledge of all the purchases. Their last purchase was July 11, 1912 at 100 1-2, that at the time of making these purchases he made inquiry with reference to the market value of bonds and the purchases made were at what he learned to be the market value in New York.

With respect to the condition of the Idaho-Oregon, reference is again made to the table of gross and net earnings (Trans. 231) from the organization of the company down to and including the year 1912, in which this transaction was had, and the fact that the gross earnings in the current year were more than $400,000.00 and the net earnings $215,-892.00, while the interest charges on the underlying divisional bonds and the first mortgage bonds (Trans. 379) was approximately $181,000.00 a year and this in spite of the fact that more than $2,000,-000.00 of the $2,494,000.00 of outstanding first mortgage bonds had been issued on account of the

Ox Bow, upon which there was no return, owing to its uncompleted condition.

As tending to establish motive on the part of the Railway Company, reference is again made to the fact that its interest bearing debt was about $7,500,000.00 (Trans. 209) entailing interest charges of $375,000.00, per annum, while its ostensible net income applicable to fixed charges (Trans. 205) was $246,000.00 of which the non-operating revenue amounting to approximately $45,000.00, was admittedly non-collectible; further that all of these first mortgage bonds of the Railway Company were in the hands of the syndicate which controlled the Railway Company and through the Railway Company controlled the Idaho-Oregon.

The testimony of Mr. Hendee, the secretary, is that under the agreement of September 25, there was an actual exchange of $440,000.00 of first mortgage bonds for second mortgage bonds. (Trans. 258).

With respect to the Bates and Rogers transaction of Dec. 27th, 1912, under which the additional $278,000.00 of bonds was exchanged, it is to be observed:

First, that Bates and Rogers were willing to take Idaho-Oregon firsts, at the current market value without guaranty and so proposed to William Mainland the president of the two companies; (Trans. 314) and

Second, that Fuller refused to do this but said

they would give seconds and the Railway Company would guarantee them.

Third, that both of the Mainlands testified that they have no recollection that an agreement to exchange more bonds as a consideration under this guaranty was a part of the tranactions of the meeting of December 27th, (Trans. 314, 320) and

Fourth, that the minutes were written by the attorney for the company, are found in the book unsigned, that the alleged secretary of the meeting, Sinclair Mainland, says he never saw them and did not know, until a few days before his deposition was taken that there had been such an alleged transaction, (Trans. 320).

Fifth, that manifestly the provisions for an exchange of bonds up to $500,000.00 has no possible relation to a guaranty of $25,000.00 of seconds at 80 for an obligation of $20,000.00; that they do not pretend to fix a definite consideration for such guaranty but named a sufficiently large amount to be exchanged to cover whatever possible certifications might thereafter be obtained.

The five directors of the Railway, the same persons being directors of the Idaho-Oregon, who represented the interests of the Railway syndicate, being respectively Mr. Wiggin, the President of the Chase National Bank, Mr. Sabin, Vice-President of the Guaranty Trust Company, Mr. Richmond of Winslow, Lanier and Company, Mr. Fuller of Kissel, Kinnicutt and Company, and Mr. Ryan of the Amalgamated Copper Company and the Montana

Power Company, resigned on February 24, 1913, as directors of the Idaho-Oregon and clerks and bookkeepers in their banks and offices were elected in their places. (Trans. 349).

Certifications of first mortgage bonds were obtained as rapidly as possible and all the bonds so obtained were transferred to the Railway Company by the exchanges.

All of these matters were presented in evidence in part, for the purpose of showing that already on September 25, 1912, the New York, or syndicate directors of the Idaho-Oregon Company were planning the default in payment of interest on its first mortgage bonds and the proceedings on that day and all the subsequent proceedings in the affairs of the company were taken not with a view to handling the affairs of the Idaho-Oregon for the best interests of that company and the holders of its bonds and stock, but with a view to permitting the default on the first mortgage bonds, and of making such preparations therefor as would conserve the interests of the Railway Company without regard for the interests of the Idaho-Oregon Company.

Much of this evidence was rendered, in a large degree, superfluous by the frank statement of counsel for the Railway Company and the *amicus curiae* upon the argument in the trial court that the Railway Company had a right to take whatever measures were in its power, through its ownership of the Idaho-Oregon stock, to protect its investment in the Idaho-Oregon property, and that on September 25,

the railway interests were of the opinion that the Idaho-Oregon could not go on without reorganization and that the measures taken then, and on December 27th, for the exchange of bonds, were for the purpose of bettering the position of the Railway Company, in view of that anticipation.

Mr. Sinclair Mainland testified (Abst. 320) that he had a conversation with Mr. Fuller just after the meeting of September 25th, in which Fuller said "that it would put them, or the railway company, in much better shape to have those bonds in case of trouble in the Idaho-Oregon."

The appellees offered to prove upon the trial (Trans. 454) that the Idaho-Oregon property was advertised for sale on December 1, 1913; that no bid was made on that date. Error is assigned upon the exclusion of that evidence. It was stipulated (Trans. 381) that on December 23, 1913, a bill was filed by a creditor against the Idaho Railway, Light and Power Company in the District Court of the United States for the Southern District of Idaho, alleging its insolvency and that a Receiver was appointed under that bill and that the Railway Company filed an answer admitting its insolvency.

It was also stipulated that for the purposes of this case the properties of the Power Company would not bring, at foreclosure sale, the amount of the first mortgage bonds. (Trans. 381).

It was agreed in the trial court (Paragraph VIII of the Decree. Trans. 163) that so far as such fact

might be at any time material, the Decree should be regarded as having been made after the sale and upon distribution, and as upon application of the Railway Company as a bondhelder to share in such distribution.

The learned District Judge in deciding the case, held:

1. That the 107 bonds certified after the default (and which are not otherwise involved in this proceeding) were properly certified by the trustee and that the objection that the trustee should not, in pursuance of its duty under the trust deed, have made such certification after the default upon the issue, was without substantial merit;

2. That from about the first of January, 1912, the Power Company was completely dominated by the Railway Company;

3. That by September, 1912, the Railway syndicate had reached the conclusion that the Power Company was insolvent; that their contract to purchase second mortgage bonds was ill-advised and that their original plan could not be profitably carried out;

4. That it is extremely doubtful whether the act of the meeting of September 25, authorizing the contract under which the Railway Company got possession of 440 bonds, was in fact or in law a corporate act;

5. That the Railway Company itself was, at that time, wholly insolvent;

6. That under the circumstances it was wholly incredible that such agreement as was undertaken to be authorized on Sept. 25th was thought by anyone to be in the interests of the Power Company; that no independent Board of Directors would have given it a moment's consideration; that although the company needed money, if it was going on with the Ox Bow development, the sum contracted for was wholly inadequate for any useful purpose and if that work was not to be resumed, there was no urgent need for such an amount; that those who participated in the transaction were unable to give any reasonable explanation of the purpose for which the $250,000.00 was to be used and that apparently there was none.

7. That the transaction practically amounted to a sale of first mortgage bonds for an equivalent amount of seconds which it was apparent must have been wholly valueless if the firsts were worth less than their face and was a surrender without any real consideration of the obligations of the syndicate to take $175,000.00 of the face value of the seconds at 80;

8. That the only rational explanation of the agreement was that the interests in control of the Railway Company and through it, of the Power Company, had concluded that the latter was hopelessly insolvent and a reorganization was inevitable, and resorted to this expedient for saving to themselves as much of the wreckage as possible;

9. That putting aside for the moment the rights of the interveners, this was a breach of trust on the part of the officers of the Power Company and a disregard of the rights of the holders of approximately $166,000.00 second mortgage bonds, which were held by the general public;

10. That the members of the syndicate as directors of the Power Company were "bound to conserve the interests of the company and hold its property for the common benefit of its creditors and they were not privileged to strip it of its meager remaining resources for the purpose of recouping their private losses."

11. That with respect to the alleged transaction of December 27, 1912, under which a further exchange of bonds was made, the stock of the Railway Company given to Bates and Rogers was worthless and its obligation to buy the bonds back from Bates and Rogers (hereinbefore referred to as a guaranty) was, because of the railway's insolvency, unenforcible and practically of no value.

12. That the Power Company could have made a settlement direct with Bates and Rogers with first mortgage bonds at a comparatively small discount and that the devious course was adopted, not upon their demand or for the interests of the Power Company, or because of any necessity therefor, but for the sole purpose of furnishing a pretext for getting the first mortgage bonds out of the treasury of the Power Company and into the hands of the Railway

Company, and for the interest alone of those by whom the latter was dominated.

13. That the corporation here was insolvent and that an insolvent corporation can not rightfully give away its property and defraud its creditors, nor can it legitimately prefer the claims of its officers and stockholders;

14. That it is a mistake to assume that the interveners contracted only for a certain security and that all their rightful demands were satisfied when it was properly certified that the requisite expenditures and improvements had been made; primarily they contracted for payment, they had a right to assume that the business of the company would be conducted fairly and honestly; the stockholders, even if they had been free to act, had no incentive to exercise vigilance, and the corporation had wholly lost the protection of its natural guardians; that in such case, the creditors alone can be affected and they alone have any interest in avoiding the contract. The creditors were entitled to have their mortgage security maintained as well as created.

15. That the Railway Company is in reality the actor (Trans. 150); that it was not content with what it was thus lawfully able to acquire through its control of the Power Company; "it is dependent upon and is here invoking the assistance of a court of equity to make actually available to it the fruits of its wrong doing. Through the trustee it seeks a foreclosure of the security of the bonds and an order distributing to it a proportionate share of the

proceeds of the property. It is asking the court to aid it in enforcing contracts the possession of which it obtained in a manner violative of sound principles of public policy and of good morals, and in that view it is quite unimportant whether the interveners would have any standing as plaintiffs in an independent suit. Regardless of who objects or whether anyone objects, a court will not knowingly assist a party to reap the fruits of its wrong doing, and under the rule the Railway Company must be denied the relief which it seeks;"

16. That the Power Company is entitled only to be protected against loss and not to be enabled to reap a profit from the attempted wrong, and that in so far as may be possible, there should be a restoration of what it has received. "While the 440 bonds acquired under the agreement of September 25, are apparently not held as collateral under the first provision of the contract, but by virtue of an exchange under a later provision, and, strictly speaking, are therefore technically subject to no other equity than the obligation to return the exchanged consolidated bonds, which are already in the possession of the Railway Company as collateral, I shall regard the substance rather than the form, and accordingly the moneys actually advanced to the Power Company under the contract of September 25th, will be charged against the bonds, such advances to be first subject to a deduction of such amount, if any, as remains of the $140,000.00 due under the original contract of September 19, 1911, after satisfying

therefrom any other claims for advances made to the Power Company properly chargeable against that obligation."

17. In a supplementary opinion (Trans. 153) the Court said that the parties having agreed that the existing record touching the transaction of September 25th, 1912, should be construed as showing that the Railway Company advanced $250,000.00 and no more, for which it is entitled to credit under the principle of the adjustment explained in the original opinion, there would be deducted the $140,000.00 due under the original contract and the Railway Company would be decreed an equitable lien upon the 440 first mortgage bonds for the balance of $110,000.00 with interest, and also be decreed the right to receive the 175 second mortgage bonds contracted for;

18. That as to the Bates and Rogers transaction, no additional evidence having been offered, it was not thought that the record shows the Railway Company to have parted with anything of value on account thereof, or to have any substantial equities in the premises.

DECREE OF THE DISTRICT COURT.

It appearing to the Court that the main action herein is a suit to foreclose a certain mortgage or deed of trust, executed by the defendant Idaho-Oregon Light & Power Company to the State Bank of Chicago, as Trustee, securing an issue of bonds to the authorized amount of $7,000,000.00, of which

3,319 of the par value of $3,319,000.00 were alleged to be issued and outstanding, said bonds being known as First and Refunding Mortgage Bonds;

And it further appearing that A. W. Priest and others, being the owners and holders, individually, of bonds of the said issue and secured by the said mortgage to the plaintiff, and also constituting and acting as a Bondholders' Committee and as such holding and representing other bonds of the same issue to a large amount, have heretofore filed their petition in intervention in said cause;

And it further appearing that by an order entered herein on September 19, 1913, the said Bondholders' Committee was authorized and permitted to intervene for certain purposes as in said order specified, and the said defendant Idaho-Oregon Light & Power Company was required to answer the allegations of the said petition with reference to a certain 718 bonds of the said issue secured by the mortgage to the plaintiff, and also with reference to a certain other 107 bonds, and also with reference to a certain other 520 bonds;

And it further appearing that the Idaho Railway, Light & Power Company was by said order made a party to the action for the purpose of answering, and was directed to answer the allegations of the said petition or bill in intervention respecting the said 718 bonds;

And the cause now coming on to be heard upon the said petition or bill in intervention, and the an-

swers of said Idaho-Oregon Light & Power Company, Idaho Railway, Light & Power Company and State Bank of Chicago to said bill in intervention, and upon the evidence taken upon the issues thus joined, and in conformity with the opinion heretofore rendered herein on August 24th, 1914;

And it further appearing that since the filing of the said bill in intervention and the said answers thereto, one W. J. Ferris has been appointed by this Court Receiver of the said Idaho-Oregon Light and Power Company and all of its property and effects, and is now in possession or entitled to the possession thereof as such Receiver, and that in another proceeding, now pending and undetermined in this Court, one O. G. F. Markhus, has been appointed Receiver of said Idaho Railway, Light and Power Company and is now in the possession, or entitled to the possession, of all the property and effects of said Idaho Railway, Light & Power Company as such Receiver.

IT IS HEREBY ORDERED, ADJUDGED AND DECREED:

I.

That said W. J. Ferris and said O. G. F. Markhus are hereby made parties to this decree, as Receivers, respectively, of said Idaho-Oregon Light & Power Company and said Idaho Railway, Light & Power Company, so far as may be necessary for its enforcement.

II.

That the said 107 bonds were duly and legally certified by the Trustee, said State Bank of Chicago, and delivered to the said defendant Idaho-Oregon Light & Power Company.

It appears from the answer of the Power Company and from some of the evidence that these bonds are now held by the Railway Company, but only as collateral, and by agreement of the parties the question of the nature and extent of the right or title of the Railway Company thereto is excluded from consideration, and this judgment is without prejudice to the determination of the status, title and ownership of the said 107 bonds in another proceeding.

III.

That the alleged agreement of September 25th, 1912, which includes the proposed exchange of bonds of the issue secured by the mortgage to the plaintiff to the number of 500, having a par value of $500,000.00, for other junior or second mortgage bonds, having a par value of $500,000.00, entitled "Consolidated First and Refunding Mortgage Bonds," secured by mortgage to the defendants Bankers Trust Company and F. N. B. Close, and the exchange of such bonds made in pursuance thereof, are illegal and void, and that the said respondent Idaho Railway, Light & Power Company is not entitled to share in the proceeds of the mortgage sale of the property covered by the said mortgage to the plaintiff, as the owner of said bonds, exchanged in pursuance there-

of, and secured by said mortgage to the plaintiff, except as hereinafter provided.

IV.

It appearing that as a part of the said agreement of Sept. 25th, 1912, the said Idaho Railway, Light & Power Company was to loan $250,000.00 to said Idaho-Oregon Light & Power Company, but that it was at the same time entitled to receive upon demand $140,000.00 in payment for the second or so-called Consolidated Bonds to the par value of $175,000.00 which right and demand was, or was attempted to be, released and discharged by and in pursuance of the same agreement; that the said $250,000.00 when so loaned was to be secured by the deposit of first mortgage bonds secured by the mortgage to the plaintiff herein, which bonds were so deposited to the amount of $440,000.00 but which in pursuance of the exchange agreement were withdrawn as such collateral and for the purpose of carrying out the said exchange, and that there were substituted therefor consolidated or second mortgage bonds as such collateral; and it appearing that all of these transactions, to-wit: the agreement for and the making of the said loan, the release by the Idaho-Oregon Light & Power Company of its right and demand to receive $140,000.00 in payment for $175,000.00 par value of consolidated bonds; the agreement for the exchange of bonds by which the Idaho-Oregon Company surrendered first mortgage bonds and received back second or consolidated bonds, and the several deposits

and exchanges of collateral in connection therewith, were all connected and interdependent and each constituting a consideration for the others;

IT IS ORDERED, ADJUDGED AND DECREED that the said Idaho-Oregon Light & Power Company, by its Receiver, W. J. Ferris, is entitled to receive back from said Idaho Railway, Light & Power Company the 440 first mortgage bonds, secured by the trust deed to the plaintiff herein, which were exchanged as part of said transaction; that the said Idaho Railway, Light and Power Company, by its Receiver O. G. F. Markhus, is entitled to receive back from the said Idaho-Oregon Light & Power Company second mortgage or consolidated bonds to the amount of $440,000.00 which it, the said Idaho Railway, Light & Power Company, gave in said exchange; that said Idaho Railway, Light & Power Company by its Receiver is entitled to recover from said Idaho-Oregon Light and Power Company the sum of $110,000.00, being the amount advanced or loaned by said Railway Company to said Power Company in excess of the $140,000.00 which the said Power Company was entitled to receive, with interest at the rate of six per cent (6%) per annum thereon, from the dates when the sums constituting the said $110,000.00 were so advanced, and that such advances and the dates thereof are as follows:

December 14, 1912.....$40,000.00
December 16, 1912..... 40,000.00
January 4th, 1913..... 30,000.00

that the said Idaho Railway, Light and Power Com-

pany, by its Receiver, is entitled to the possession, as collateral security for the repayment of the said $110,000.00 and interest, of the $440,000.00 of first mortgage bonds originally deposited by said Idaho-Oregon Light & Power Company as collateral for the loan agreed to be made on September 25th, 1912. It appearing that the $440,000.00 of first mortgage bonds are now in the possession of the said Idaho Railway, Light & Power Company, or its Receiver, IT IS ORDERED AND ADJUDGED that he retain the same, but not as the property of the said Idaho Railway, Light & Power Company but as collateral to the said indebtedness of $110,000.00 and interest, as above set forth, and that all second mortgage or consolidated bonds held by said Idaho Railway, Light & Power Company, or its Receiver, as collateral to the indebtedness, or alleged indebtedness, growing out of the agreement of September 25, 1912, be surrendered by said Idaho Railway, Light & Power Company and its Receiver to said W. J. Ferris, Receiver of said Idaho-Oregon Light & Power Company.

V.

That upon sale of the mortgaged property under the foreclosure proceedings herein the said Idaho Railway, Light & Power Company, or its Receiver, shall be entitled to share in the proceeds thereof, as the holder of said 440 bonds as collateral to secure the said indebtedness of $110,000.00 and interest.

VI.

It further appearing that in December, 1912, a

further agreement, or pretended agreement, was made by the said Idaho-Oregon Light & Power Company and said Idaho Railway, Light & Power Company, whereby a further exchange of first mortgage bonds secured by the mortgage to the plaintiff herein, which the said Idaho-Oregon Light & Power Company was then entitled to issue under said first mortgage, were to be exchanged for second or consolidated bonds, issued by said Idaho-Oregon Light & Power Company, up to a total par value of $500,000.00 in consideration of an agreement made, or to be made by said Idaho Railway, Light & Power Company, whereby said Idaho Railway, Light & Power Company was to contract with the Bates & Rogers Construction Company to purchase back upon a certain demand from said Bates & Rogers Construction Company $25,000.00 face value of the Power Company's consolidated bonds, and also to issue to the said Bates & Rogers Construction Company fifty (50) shares of the preferred and one hundred (100) shares of the common stock of the Railway Company; and it further appearing that an additional 278 first mortgage bonds, secured by the mortgage to plaintiff herein, having a par value of $278,000.00 were so exchanged with the Railway Company for second or consolidated bonds of said Power Company, then held by said Railway Company, having a par value of $278,000.00;

IT IS FURTHER ORDERED, ADJUDGED and DECREED, that the said agreement for such further exchange is illegal and void, and the exchange

made thereunder invalid and fraudulent, and that said Idaho Railway, Light & Power Company, or its Receiver, shall return to said Idaho-Oregon Light & Power Company or its Receiver the said 278 first mortgage bonds, having a par value of $278,000.00, and that the said Idaho-Oregon Light & Power Company or its Receiver shall return to said Idaho Railway, Light & Power Company or its Receiver the said second or consolidated bonds to the par value of $278,000.00, so far as they may be in its or her possession either now or in pursuance of the foregoing portion of this Order, and that so far as they may be already in the possession of the Railway Company the said Idaho-Oregon Light & Power Company and its Receiver shall relinquish all right and title thereto.

VII.

IT IS FURTHRER ADJUDGED AND DECREED, that Idaho Railway, Light & Power Company is entitled to receive from Idaho-Oregon Light & Power Company second or consolidated mortgage bonds of said Idaho-Oregon Light & Power Company, secured by the deed of trust of said Bankers Trust Company and F. N. B. Close, to the par value of $175,000.00 on account of the $140,000.00 charged against the advances to the Idaho-Oregon Company. And it is ORDERED that upon sale and distribution under the foreclosure herein, said Idaho Railway, Light & Power Company shall be entitled to share in the distribution of the surplus for the second mortgage bondholders, if any, as the holder

of such bonds, to the par value of $175,000.00 in addition to other second mortgage bonds which it now holds or to which it is entitled; and in the meantime said Idaho-Oregon Light & Power Company shall, upon demand from said Idaho Railway, Light & Power Company, deliver the said second or consolidated mortgage bonds to the par value of $175,000.00.

VIII.

This decree is entered in advance of sale and distribution under the said foreclosure at the request of and for the convenience of the parties, and upon the agreement in open court, all parties hereto consenting, that this decree shall be regarded so far as such fact may be at any time material, as having been made after sale and upon distribution, and as upon an application of said Railway Company as bondholders to share in such distribution and as against objection by these intervening bondholders and that no objection shall be made to said decree by any party affected thereby at any time or place upon the ground that the same is premature or untimely.

Entered this 18th day of September, 1914.

FRANK S. DIETRICH,
District Judge.

Filed September 19, 1914.

From this decree the Receiver of the Railway Company, the Railway Company and the Idaho-Oregon Company appealed and the interveners, A. W.

Priest and others, as a bondholders committee prosecuted a cross appeal assigning the following errors (Trans. 521).

ASSIGNMENT OF ERRORS BY CROSS APPELLANTS.

I.

Because the said court erred in holding and deciding that the said Idaho Railway, Light & Power Company and O. G. F. Markhus, as its Receiver, should be recognized as having an equity in the 718 bonds mentioned in said decree corresponding to the consideration it had paid out, and of which the Idaho-Oregon Light & Power Company received benefit.

II.

Because the said court erred in holding and deciding that the said 718 bonds should not be returned or cancelled or annulled until there had been a restoration by the Idaho-Oregon Light & Power Company, or its Receiver, of what said Company had received under the contracts or by virtue of the transactions annulled or set aside by the court in its said decree, and under or by virtue of which the said Idaho Railway, Light & Power Company received the said 718 bonds.

III.

Because the said court erred in holding and deciding that the moneys actually advanced to the Idaho-Oregon Light & Power Company by the Idaho Railway, Light & Power Company under the con-

tract of September 25th, 1912, should be charged against the said bonds after deducting the $140,000.00 due the Idaho-Oregon Light & Power Company under the contract of September 19th, 1911.

IV.

Because the said court erred in holding and deciding that the Idaho Railway, Light & Power Company and its Receiver, O. G. F. Markhus, were entitled to hold the said 718 bonds, or any of them, as security for any money paid, or claimed to have been paid or advanced, to the Idaho-Oregon Light & Power Company under any contract or agreement whatsoever.

V.

Because the said court erred in not holding and deciding that the said 718 bonds, and each and every of them, should be forthwith returned by the Idaho Railway, Light & Power Company and its said Receiver to the Idaho-Oregon Light & Power Company, or its Receiver, without requiring any sum whatsoever to be paid to said Idaho Railway Light & Power Company, or its Receiver.

VI.

Because the said court erred in holding and deciding that the said Idaho Railway, Light & Power Company and its said Receiver had any right or claim whatsoever in or to the said 718 bonds.

VII.

Because the said court erred in admitting in evidence what purports to be a copy of the Minutes

of the meeting of the Executive Committee of the Idaho-Oregon Light & Power Company, held in the Chase National Bank December 27th, 1912, the same being marked "Respondents' Exhibit B re 718 Bonds," and to the admission of which counsel for the interveners duly objected; and to the ruling of the court admitting the same, counsel duly excepted, and still except, and which exception was by the court allowed.

VIII.

Because the said court erred in denying the motion of counsel for these interveners to strike from the record said alleged minutes of the meeting of the Executive Committee of December 27th, 1912, to which ruling of the court counsel for interveners duly excepted and still except, which exception was allowed by the court.

IX.

Because the said court erred in sustaining the objection to the following offer of evidence made by counsel for these interveners: "MR. CUMMINS: Now, I wish to offer to prove that the property in question was advertised for sale on December 1st, 1913; that theretofore a proposal to bid not less than $1,500,000 for the property, if the property were offered not later than December 15, had been made in writing; that no bid was in fact made on December 1st, 1913; that the sale was continued to March 16th, 1914, and that on that date there appeared at the time and place named for such sale, a bidder representing or claiming to represent the Railway

Company or the interests connected therewith, who offered $1,000,000 for the property; that the Receiver of the Idaho Railway, Light & Power Company was represented there by counsel, and, as a bondholder of the Idaho-Oregon Company, urged the acceptance of the bid. I am making that offer for the purpose of threshing out the question of its admissibility." To which offer objection was made by counsel for the Idaho Railway, Light & Power Company and its Receiver, which objection was sustained by the court; to which ruling of the court counsel for these interveners duly excepted, and still except, and which exception was allowed by the court.

X.

Because the said court erred in not admitting in evidence what is known as the Circular of the New York Committee of March 26th, 1913, and the proposed Bondholders' agreement of May 1st, 1913, and the circular of the New York Committee, bearing date May 1st, 1913, relative to the plan of reorganization proposed by the New York Committee, the same being, respectively, Exhibits "A," "B," and "C" attached to the answer of the State Bank of Chicago, Trustee, to the bill in intervention of these interveners; and to the ruling of the court excluding the same, counsel for interveners duly excepted, and still except, and which exception was allowed by the court.

XI.

Because the said court erred in sustaining the

objection of counsel for the Idaho Railway, Light & Power Company and its Receiver to that portion of the deposition of Samuel L. Fuller, commencing with the question, "Q. What efforts did the New York Committee ever make after putting out the plan of May 1st, 1913, to obtain the assent of the Bondholders to that plan?" On page 131 of said deposition, and extending to and stopping just before the last question on page 133 of said deposition; (the evidence so excluded being set out at length in the supplemental statement settled and allowed by the court herein under Equity Rule 75). To the ruling of the court excluding such evidence, counsel for these interveners duly excepted, and still except, which exception was allowed by the court.

XII.

Because the said court erred in sustaining the objection of counsel for the Idaho Railway, Light & Power Company and its Receiver to that part of the deposition of Samuel L. Fuller, commencing with the question, "Q. At the invitation of yourself, as Chairman of the New York Committee, a conference was held in your office in New York in April, 1913, with reference to the assembling of these bonds in the hands of the New York Committee, was there not?" On page 126 of the deposition of said Samuel L. Fuller and extending to the last question on page 129 of said deposition, (the evidence so excluded being set out at length in the supplemental statement settled and allowed herein under Equity Rule 75.) To the ruling of the court excluding such evidence coun-

sel for these interveners duly excepted, and still except, and which exception was allowed by the court.

WHEREFORE, these interveners, hereinbefore named, pray that said decree be modified to the extent of requiring the said Idaho Railway, Light & Power Company and its Receiver, O. G. F. Markhus to forthwith deliver and turn over to the said Idaho-Oregon Light & Power Company and its Receiver the said 718 bonds, and that the said Idaho-Oregon Light & Power Company and its said Receiver be held entitled to the delivery and possession of said bonds without first making the payment required under the decree of the said District Court, and for such other relief as may be just and proper.

By inadvertence the assignments of error by the cross appellants refer to 718 bonds where they should refer to 440 bonds, the District Court having decreed an equitable lien in favor of the Railway Company against 440 bonds only and directed the surrender to the Idaho-Oregon Receiver of the other 278 bonds without lien or qualification. The cross appellants therefore respectfully express the desire that 440 be regarded as substituted for 718 wherever those figures appear in the assignments of error by cross appellants.

In the title of the cause the name Idaho-Oregon Light & Power Company appears first as appellant, which is likely to give rise to misapprehension. If

the Idaho-Oregon be regarded as properly joined as appellant, it is a purely nominal appellant, the real and sole appellant in legal interest being O. G. F. Markhus, Receiver of the Railway Company.

The questions raised by the appeal and cross appeal are so related that they will not be discussed under separate divisions of the brief or argument, but as a single connected series of questions.

QUESTIONS PRESENTED BY THE APPEAL AND CROSS APPEAL.

I.

In view of the interests and relations of the Directors participating in the meeting of September 25th, 1912, and the affirmative vote cast thereat, was the action of that meeting a valid corporate act?

II.

Was the transaction of September 25, 1912, by which the Railway Company obtained $440,000.00 of Idaho-Oregon first mortgage bonds a legal and valid transaction in view of the circumstances and the relations of the two corporations, and will it stand against the objection of other holders of first mortgage bonds who are prejudiced thereby?

III.

If it is held that the Railway Company cannot lawfully retain the 440 bonds as owner and share in the proceeds of the sale as such owner with the other first mortgage bondholders, what effect, if

any, should the enforced surrender have upon the other two contemporaneous parts of the transaction, namely the release of the Railway Company from its obligation to pay an additional $140,000 to the Idaho-Oregon for second mortgage bonds and the loan by the Railway Company to the Idaho Oregon of $250,000 upon collateral?

IV.

If the whole transaction be held to be tainted with fraud against the corporation and its creditors and to constitute at the same time an unlawful preference, is the Receiver of the Idaho-Oregon to be regarded as entitled to tender 175 second mortgage bonds to the Receiver of the Railway Company and deduct the $140,000, the purchase price thereof, from the $250,000 leaving a balance of $110,000 in the transaction?

V.

Do the mortgage creditors stand only in place of the corporation avoiding and rescinding the transaction and so equitably required to restore the previous status or are they standing here upon their own independent rights, objecting to sharing the proceeds of the sale with the holders of bonds obtained fraudulently and therefore not concerned with the transaction by which the bonds were obtained, to which they were not parties, but concerned only with their fraudulent character?

VI.

Was the agreement of December 27th, 1912, concerning the Bates and Rogers settlement and the

further exchange of $500,000.00 of bonds authorized, and was it a corporate act?

VII.

If it be held that the transaction was duly authorized by the Executive Committee of the Idaho-Oregon, was it a legal and valid transaction in view of the circumstances and the relations of the two corporations, or was it fraudulent and invalid as to the corporation and its creditors?

POINTS AND AUTHORITIES.

I.

The proceedings of the meeting of the Directors of the Idaho-Oregon held September 25, 1912, which are in controversy, were not valid corporate acts.

See cases cited *infra* under point III.

II.

Directors are not permitted to create any relation between themselves and their corporation or its property which will make their personal interests antagonistic to that of the corporation.

10 Cyc. 790.

Cook v. Sherman, 20 Fed. 167, (Cir. Ct., Dist. of Iowa, 1882, Justice McCreary).

III.

A director cannot with propriety vote in the board of directors upon a matter affecting his own private interest; any resolution passed at a meeting of the directors at which a director having a personal interest in the matter voted will be voidable at the in-

stance of the corporation or its shareholders without regard to its fairness providing the vote of such director was necessary to the result.

10 Cyc. 790.

Graves v. Mono Lake Hydraulic Mining Co., 81 Cal. 303; 22 Pac. 665, (Sup. Ct. of Cal. 1889).

Paxton v. Heron (Colo. 1907), 92 Pac. 15.

Steele v. Goldfisher Mining Co. (Colo. 1908), 95 Pac. 349.

Gold Glen Mining Co. v. Stimson, (Colo. 1908), 98 Pac. 727.

Godley v. Crandall, 139 N. Y. Supp. 236.

Burns v. Mining Co., 23 Colo. App. 545; 136 Pac. 1037.

2 Cook on Stock and Stockholders, Sec. 653.

Morgan v. King, 27 Colo. 539; 63 Pac. 416.

Mosher v. Sinnott, 20 Colo. App. 454; 79 Pac. 742.

Sims v. Petaluma Gas Co., 131 Cal. 653; 63 Pac. 1011.

Woodruff v. Howe, 26 Pac. 111, (Cal. 1891).

Cooms v. Barker, 79 Pac. 1, (Mont. 1905).

Smith v. Los Angeles I. & L. Co-op. Assn., (Cal. 1889), 20 Pac. 667.

Chamberlin v. Pacific Woolgrowers Co., 54 Cal. 103.

10 Cyc. 811.

Coleman v. Second Ave. R. R. Co., 38 N. Y. 201.

Higgins v. Lansingh, 154 Ill. 301, 40 N. E. 362.

IV.

Contracts made by directors who at the same time represent an opposing interest, generally where the other contracting party is a corporation in which they are also directors, are not void ab initio but are voidable in a proper proceeding taken for that purpose by the corporation, its shareholders, *or its creditors.*

10 Cyc. 791.

Charter Gas Engine Co. v. Charter, 47 Ill. App. 36.

Michigan Slate Co. v. Iron Range Co., 101 Mich. 14; 59 N. W. 646.

There are authorities which go to the length of holding that a contract in which some of the directors are interested on both sides is void in such a sense that it will not be enforced in a court of justice. But the weight of authority probably is that such contracts are merely presumptively invalid and that the burden of showing that they are entirely fair is upon those claiming under them and that they will be subject by courts of equity to the severest scrutiny and set aside unless all appearance of bad faith is removed by the evidence.

10 Cyc. 808.

Gardner v. Butler, 30 N. J. Eq. 702.

Skinner v. Smith, 134 N. Y. 240, 31 N. E. 911.

Barr v. N. Y. etc. R. R. Co., 125 N. Y. 263; 26 N. E. 145.

Welsch v. Importers, etc. Bank, 122 N. Y. 177; 25 N. E. 269.

Munson v. Syracuse R. R. Co., 103 N. Y. 58; 8 N. E. 355.

McGurrkey v. Toledo R. R. Co., 146 U. S. 536, 36 L. Ed. 1079.

Wardell v. Union Pac. R. R. Co., 103 U. S. 651; 26 L. Ed. 509.

10 Cyc. 808-9.

Wilbur v. Lynde, 49 Cal. 290.

Andrews v. Pratt, 44 Cal. 309.

San Diego v. San Diego R. R. Co., 44 Cal. 106.

Hoffman Steam Coal Co. v. Cumberland Coal Co., 16 Md. 456.

Cumberland Coal Co. v. Sherman, 30 Barber 553.

Pickett v. Wiota School Dist., 25 Wis. 551.

V.

One view of the subject is that where all or the majority of the directors of either of two corporations contracting together are directors in the other, the contract made between the two corporations will be invalid on the theory of a want of contracting parties so that it may be avoided by either corporation at the instance of a shareholder of either or by a creditor under proper circumstances without regard to the question whether it is detrimental to either and no matter how open and seemingly fair it may be.

Another view is that a contract between two corporations affected by the votes of directors who are common to both is presumptively invalid and can

only be sustained by an affirmative showing of fairness and good faith.

The better reasoning seems to be that where all or a majority of the directors of two corporations are the same, a contract between them may be avoided by either corporation at its election without regard to the good faith of the transaction and without showing injury; but where avoidance is sought by any other than the corporation itself, as by a stockholder or a creditor, the contract while presumptively invalid, may be sustained upon proof of good faith and of benefit to the corporation itself, the burden of establishing good faith and beneficial character being upon those seeking to sustain the contract. The ground for this distinction lies in the fact that while the corporation itself may elect absolutely to avoid the contract, the same parties having undertaken to represent adverse interests, and being its own exclusive judge of whether it is benefited, if any other interests under the corporation but less than the corporation itself seek to avoid, the contract may, nevertheless, be sustained if good faith and benefit to the corporation be affirmatively shown.

10 Cyc. 818-9.

German Natl. Bank v. Hastings First Natl. Bank, 55 Neb. 86, 75 N. W. 531.

Fitzgerald v. Fitzgerald Const. Co., 44 Neb. 463, 62 N. W. 899.

Bear River Valley Orchard Co. v. Miller, 15 Utah 506, 50 Pac. 611.

Hutchinson v. Sutton Mining Co., 59 Fed. 998.

Martin v. Santa Cruz Water Storage Co., (Ariz. 1894), 36 Pac. 36.

Bill v. Western Union Telegraph Co., 16 Fed. 14 (Cir. Ct. So. Dist. N. Y. 1883).

Goodin v. Canal Co., 18 O. St. 169, 98 Am. D. 95.

Sweeney v. Refining Co., 30 W. Va. 443, 4 S. E. 431.

R. R. Co. v. Woods, 88 Ala. 630, 7 So. 108.

Geddes v. Anaconda Copper Min. Co., (Dist. Ct. Mont. 1912, opinion by Justice Hunt), 197 Fed. 860.

R. R. Co. v. Minis, 120 Md. 461, 87 Atl. 1062.

Church v. Church, 45 Barb. 356.

Bank v. Bank, 105 S. W. 338.

Booth v. Robinson, 55 Md. 419.

Davis v. Power Co., 77 Md. 35, 25 Atl. 982.

Pierson v. Railway Corporation, 62 N. H. 537.

VI.

The rule that contracts between corporations having a common directorate may be avoided may be invoked by a creditor as well as by the corporations and their stockholders.

10 Cyc. 791.

Washburn v. Greene, 133 U. S. 30; 33 L. Ed. 516.

Sweeney v. Grape Sugar Company, (W. Va.) 4 S. E. 431.

VII.

Directors cannot prefer themselves as creditors

to the injury of the other creditors of the corporation.

Lippincott v. Shaw Carriage Co., 25 Fed. 577, (Cir. Ct. of Ind. 1885, opinion by Justice Woods, p. 585.)

Howe, Brown & Co., v. Sandford Fork & Tool Co., 44 Fed. 231; (Cir. Ct. of Ind. 1890, opinion by Justice Woods.)

Jackson v. Ludeling, 88 U. S. 616, 22 L. Ed. 492.

10 Cyc. 803.

Kittell v. Augusta R. Co., 65 Fed. 859.

Gottlieb v. Miller, 154 Ill. 44; 39 N. E. 992.

Reynolds v. Smith, 60 Neb. 197, 82 N. W. 627.

Kittell v. Augusta R. Co., 78 Fed. 855, (Cir. Ct. Southern Dist. N. Y. 1897.)

VIII.

This is not a case of avoidance or recission by the corporation or by a party acting by subrogation to the rights of the corporation. The mortgage creditors should be viewed as acting in their own right by objection upon distribution to sharing the deficient proceeds of the sale with bonds obtained by fraud and so not valid and outstanding obligations under the mortgage, and constituting also an unlawful preference.

ARGUMENT.

I.

The proceedings of the meeting of the Directors of the Idaho-Oregon held September 25, 1912, which are in controversy, were not valid corporate acts.

Every one of the Directors of the Idaho-Oregon was also a Director of the Railway Company. We have then here the legal proposition that contracts between the two corporations authorized and depending upon the acts of the Directors are presumptively invalid though perhaps susceptible of ratification by the stockholders. This proposition will be discussed under another head.

In addition to this identity of the Directors is the fact that Richmond, Wiggin, Sabin, and Fuller were members of the Railway Syndicate which owned *all* the securities of the Railway Company and who were therefore directly and personally interested in a way separate and distinct from their trusteeships as directors of the Railway Company.

In the third place not only was Fuller directly disqualified from acting because he was a member of the partnership of Kissel, Kinnicutt and Company, a party to the contract, which disqualification he recognized by refraining from voting, but William and Sinclair Mainland were equally disqualified for exactly the same reason. They were parties to the original syndicate agreement of September 19, 1911, and they were parties to the new agreement of September 25, 1911, which, by one of its provisions, modified the old syndicate agreement. Un-

der this narrowest one of the rules applying to the situation therefore, three directors out of the eight present were clearly disqualified by being directly parties to the contract which was adopted. This left five or less than a quorum of the full board. Of these five, one, Thompson, voted in the negative so that this vital and radical step, which changed and was intended to change the whole future of the corporation and lead it directly toward the brink of the grave prepared for it, was adopted by the affirmative vote of four directors out of a total board of eleven, and these four were directors of the co-contracting corporation, whose assets would be directly enhanced by adding approximately one-fourth of the entire assets of the Idaho-Oregon, by this little coup.

While the learned District Judge does not rest his final conclusions upon any technical considerations of the legal sufficiency of these attempted acts of the board, he remarks that (Trans. 138) "it is extremely doubtful whether what was done at the meeting could in fact or in law be deemed a corporate act." A detailed examination of some of the authorities bearing upon this proposition will be found under III.

II.

Directors are not permitted to create any relation between themselves and their corporation or its property which will make their personal interests antagonistic to that of the corporation.

Cook v. Sherman, 20 Fed. 167.

There is an extended note to this case by J. C. Harper, Esq., of the Cincinnati Bar, which discusses the relation of confidence existing between the director and the stockholders of a corporation, the matter of an adverse interest necessary to render a contract invalid, when an officer may acquire an interest adverse to the corporation, and the confidential relations of directors to the creditors of the corporation. The general proposition is doubtless unimpeachable, but it is not construed to render impossible transactions between a director and his corporation and its application to the case at bar would be more profitably considered under subsequent heads.

III.

A director cannot with propriety vote in the board of directors upon a matter affecting his own private interest; any resolution passed at a meeting of the directors at which a director having a personal interest in the matter voted upon, will be voidable at the instance of the corporation or its shareholders without regard to its fairness providing the vote of such director was necessary to the result.

In Graves v. Mono Lake Hydraulic Company, 81 Cal. 302, 22 Pac. 665, the directors of a mining company held a meeting at which four were present, including the President, Secretary and Superintendent. Salaries to all three were voted and notes given secured by mortgage to secure the indebtedness thus created. The case was an action to foreclose the mortgage.

It was held that the resolutions were not legally adopted and were voidable at the election of the corporation or at the election of a minority of the stockholders in case the corporation had refused to avoid them, without regard to whether they were fair and honest or not; citing Andrews v. Pratt, 44 Calif. 309; San Diego v. Railroad Company, 44 Calif. 106; Wilbur v. Lynde, 49 Calif. 290; Chamberlain v. Wool Growing Co., 54 Calif. 103; Tracy v. Colby, 55 Calif. 67; Wardell v. Railroad Co. 103 U. S. 651; Koehler v. Iron Co., 2 Black 715, and 1 Morawetz, Private Corp'ns., Sec. 516-520.

A note on this case says a contract between a corporation and individuals some of whom are directors of the corporation is voidable at the option of the corporation, citing cases. * * * And on a sale of corporate property to one of the directors taking part in the transaction as buyer and seller, it devolves upon the directors to establish the good faith of the transaction and that the sale produced the full value of the property, citing Wilkinson v. Bauerle, (N. J.), 7 Atl. Rep. 514.

In Paxton v. Heron, (Colo. 1907), 92 Pac. 15;

Three of five directors of a corporation voted one of the three a salary as secretary. Held invalid, the vote of the person interested being necessary to the action.

In Steele v. Goldfisher Mining Co., (Colo. 1908), 95 Pac. 349, two of three directors had their salaries as officers fixed by one resolution covering both salaries. Held invalid.

In Gold Glen Mining Co. v. Stimson, (Colo. 1908), 98 Pac. 727, the officers of the corporation advanced money for the development of the company's mines under an agreement whereby the money was to be repaid only out of the net proceeds of the sale of the ore. A resolution adopted by three of its directors, two of whom had advanced money to it, authorizing the execution of the company's notes, was held invalid. "Besides, two of the directors who voted for this resolution were not competent to act. They made advances and by the resolution were also to receive notes. Their self interest in securing the acknowledgment and payment of these debts and their duty to the company conflict. The resolution depending as it does on their votes is void and does not bind the company."

In Burns v. Mining Co., 23 Colo. App. 545; 136 Pac. 1037, the corporation borrowed money of one of its directors and a note was given. In a suit upon the note it was held that the note was invalid because the vote of the payee was necessary to the authorization of the note. If the presence and vote of the director loaning the money is necessary to constitute a quorum and to make a majority upon such vote, the act is voidable at the instance of the corporation or its stockholders. The trust relations existing between the directors and stockholders of a corporation ought not to permit such an act and a court of equity will scrutinize all contracts made in this way and set them aside regardless of the good faith of the transaction.

In Smith v. Los Angeles O. & L. Co-op. Assn. 20 Pac. 667, a director of a corporation was held disqualified to vote at a meeting of the Board of Directors upon a resolution authorizing the renewal of notes in his own favor.

Where the directors, who assume to make a contract between a corporation and themselves as individuals, constitute a majority of the board, the contract will not be binding upon the corporation. The principle is that a disinterested majority of the directors is necessary to a contract with a corporation through the action of the board and that a contract is invalid if the vote of an interested member of the board is necessary to make it, whether the directors acted in good faith or not.

10 Cyc. 811.

Coleman vs. 2nd Ave. R. R. Co., 38 N. Y. 201.

Higgins v. Lansingh, 154 Ill. 301, 40 N. E. 362.

IV.

Contracts made by directors who at the same time represent an opposing interest, generally where the other contracting party is a corporation in which they are also directors, are not void ab initio but are voidable in a proper proceeding taken for that purpose by the corporation, its shareholders, OR ITS CREDITORS.

In the case of McGurrkey vs. Toledo R. R. Co. 146 U. S. 536, a railroad company made contracts by which it leased rolling stock from a syndicate com-

posed mostly of those interested in the organization of the road and money was raised by car trust securities issued to themselves or persons in confidential relations with them. The transaction was declared a constructive fraud upon the prior mortgagee of the railroad. An extensive note to this case discusses the dealings of the officers of the corporation with the corporation or with its property, citing a large number of cases. The note declares that a valid mortgage cannot be given by an insolvent corporation which has not suspended business to some of its stockholders, nearly all of whom are directors, to indemnify them from liability as endorsers on its paper over due and about to become due, and cites Howe v. Sandford Fork & Tool Company, 44 Fed. 231.

In Wardell v. Union Pacific R. R. Co., 103 U. S. 651 the directors of the Union Pacific Railroad Company made a contract between themselves and the railroad company by which they should prospect for coal along the line of the railroad and the railroad company should buy coal of them and the company leased coal bearing lands to these persons. A corporation was formed to develop and work the mines, the majority of the stock of which taken by six of the directors of the railroad company, one of whom was its president. Held that the contract was a fraud upon the company. The character of the directors as agents for the company forbade the exercise of their powers for their own personal interests against the interests of the company. They were thereby

precluded from deriving any advantage from contracts made by their authority as directors except through the company for which they acted.

V.

Where all or a majority of the directors of two corporations are the same, a contract between them may be avoided by either corporation at its election without regard to the good faith of the transaction and without showing injury, but where avoidance is sought by the stockholders or a creditor, a contract while presumptively invalid may be sustained upon proof of good faith and a benefit to the corporation, the burden of establishing good faith and beneficial character being upon those seeking to sustain the contract.

In the case of German National Bank v. Hastings First National Bank, 55 Neb. 86, 75 N. W. 531, the president, one director and a stockholder, who was not a director, acting without authority from the board of directors sold all the visible assets of this insolvent corporation and turned the proceeds of the same over to a single creditor, a corporation in which two of the persons so acting were interested and of which they were directors.

These acts were reported to a meeting of the board of directors attended by four out of seven members, two of the four being directors of the preferred corporation also. They did not in fact act upon it. The Court says that as a board of directors they could have done nothing which would bind the corporation

because, of the four present, two were directors of the preferred corporation. Their votes, or the vote of one of them would be essential to action and a resolution so adopted would be voidable. "It is true that there is a conflict of authority as to the character of this act moved by the votes of common directors of two contracting corporations but the question discussed is not whether such contracts are valid for it is conceded they generally are not. The question is whether they are always voidable at the election of the stockholders or whether they may be sustained on an affirmative showing of fairness and good faith."

In the case of Fitzgerald v. Fitzgerald Const. Co., 44 Neb. 463, 62 N. W. 899, a majority of the directors of the construction company were officers of the railroad company and included George Gould and Russell Sage, the court said: "Never was the infallible truth that a man cannot serve two masters better illustrated than by the facts of this case. Each party to the agreement was interested in securing the most advantageous terms consistent with fair dealing and with the rights of the other. Hence, Messrs. Gould and Sage could not at the same time protect the rights of both corporations. Conceding the personal integrity of the directors named as well as of Mr. Cross who acted with them, still the law has placed the seal of its disapproval upon the transaction and pronounced it fraudulent, not on account of any imputed evil purpose on their part but for motives of public policy. It was said in Gordon v.

Canning Co., 36 Neb. 548, 54 N. W. 830, that the relation of directors to the stockholders of a corporation is not essentially different from that ordinarily existing between trustee and cestui que trust. Courts of equity will set aside such contracts for fraud and generally on a slight showing of fraud on the part of the trustee. And the proposition that this transaction is fraudulent as against the construction company without regard to the motives of the directors named is sustained by the following, among the many cases which might be cited to the same effect: Citing U. S. Rolling Stock Co. v. Atlantic and G. W. R. R. Co., 34 O. St. 450. Kitchen v. R. R. Co., 69 Mo. 224. Flagg v. R. R. Co., 10 Fed. 413. Beach, Private Corp'ns, 247."

In the Bear River Valley Orchard Co. v. Miller, 15 Utah 506, 50 Pac. 611, the acting parties were officers and directors of two corporations. The court, on page 614, says these officers could not act adversely to the interest of their companies for their own benefit and so cannot bind their principals by contracts with respect to subjects in which they may have opposing interests. In such a case, their own interest may interfere with their duty to their principal. Self-interest may turn out to be a stronger motive than their obligations to their principals. Under such circumstances, the law will not allow them to serve two masters, to be led into such temptation.

Bill v. Western Union Telegraph Co., 16 Fed. 14, (Cir. Ct. So. Dist. N. Y. 1883).

The Gold and Stock Telegraph Co. made a lease of its property to the Western Union Tel. Co. for 99 years. A majority of the directors of the lessor were directors of the lessee and the lessee owned nearly two-fifths of the stock of the lessor.

The lease was held invalid. The court said: "If the directors of the lessor were not competent to vote because they were at the time directors of the lessee, the lease is void. It cannot be supposed that the requisite quorum has been obtained or that the statute contemplates or is satisfied by a vote of directors who are incompetent to vote. But the theory that the directors were incompetent to vote confounds the distinction between want of power and abuse of power; between a disqualification to vote which renders the vote nugatory and the exercise of a power which has been conferred but which ought not to be exerted. A director is not incompetent to vote because a sense of propriety may demand that he should not vote upon a particular occasion nor is an agent incompetent to make a contract because the contract he had made was unfair or even fraudulent toward his principal; if the directors were incompetent to vote, the lease would be absolutely void and no action of the stockholders could validate it. If, however, the act of the directors was culpable or obnoxious to equity under the circumstances, while the corporation might repudiate their contract, it might also ratify it and would ratify it by accepting the benefits of the transaction with knowledge of the facts. * * * Although the honesty of the agent

may be unquestioned and he may have attempted to exercise scrupulous impartiality as between his own interests and those of his principal, it is the right of the latter to repudiate the transaction. Directors of corporations are its agents invested with wide powers and clothed with large discretion. They represent stockholders who are often practically voiceless in behalf of their own interest and they are held to the exercise of the utmost faith in the administration of their trust. They abuse the fiduciary relation which they sustain to the corporation and the stockholders when they enter into contracts in which their private interests may antagonize the interests committed to their care. The law does not require the corporation to take the chances that the directors have not abused their position under such circumstances.

Practically and logically, there can be no difference in the complexion of the transaction when the agent or the director instead of opposing his personal interests between his principal and himself, interposes those of a third person. * * * Applying these principles to the case in hand, the conclusion is obvious if the directors could not enter into a contract with the lessee which the lessor could not repudiate because of the peculiar relations existing between the lessee and the directors, they could not bind the lessor by a vote which was the equivalent to a contract or was indispensable to the validity of the lease."

Geddes v. Anaconda Copper Min. Co., (Dist. Ct. Mont. 1912, opinion by Justice Hunt), 197 Fed. 860.

The Alice Gold and Silver Mining Co. undertook to sell its property to the Anaconda Copper Mining Co., both being controlled by John D. Ryan, one of the Railway Directors here. There were other involved interests concerning the Buhl Co-operation Company and the Amalgamated Copper Company. The complainant sought an injunction to restrain the Anaconda Copper Mining Company from transferring the stock, pending litigation as to the validity of the sale. "Upon principle, contracts between corporations having a common directorate should be regarded very much as are contracts between individual directors and their corporations. Such contracts are not prohibited nor are they prima facie void or fraudulent but they are voidable and it is a safe rule of conduct which imposes upon those who would sustain them the duty of showing clearly and satisfactorily that they are entirely fair and free from wrong. In the light of the complexities that have come to surround corporation transactions, whereby interlocking directorates are frequently acting for corporations dealing with each other, opposing interests are often involved.

"For example, plainly, it is to the interest of a corporation which sells its property to receive as large a consideration as possible for it. Equally clear it is that it is to the interest of a buying corporation

to buy for as small a price as it properly can, but if we have one director who is a managing director acting for the selling concern who at the same time represents the buying concern and who is a managing director for it, necessarily we have an apparent conflict of interests, a conflict that upon complaint by minority shareholders, the law must become concerned with and will inquire into with exceeding circumspection.

"The books are not harmonious in their discussion of the better view to take of a transaction such as the evidence discloses the one under examination was, but after reading the many cases cited and others referred to by text writers, we can well approve of the doctrine stated by Thompson that such contracts while not void are voidable. He says:

> 'Contracts between corporations having a common directorate are regarded by the courts very much with the same suspicion as contracts between individual directors and their corporations. Some courts have gone to the extent of holding that such contracts are prima facie fraudulent and void but the more general as well as the more reasonable rule is that such contracts are not void but voidable, and the fairness of such contracts must be shown by clear and convincing proof and it must be made to appear that they are absolutely free from fraud. Contracts between corporations having a common directorate are voidable although there was a

quorum of each board of directors who were not directors in the other.'

2 Thompson on Corporations, Sec. 1242.

The same author also writes as follows (Sec. 1243):

'Contracts of consolidation, lease or sale, are frequently entered into between corporations where the directors of one are largely interested in the stock of the other, or where one corporation owns a majority of the stock of the other contracting corporation; or where the stockholders of the two corporations are practically the same. Such contracts are covered by the same rule substantially as those where directors deal with themselves or with the corporation.'

"My conclusion is that the burden is cast upon the defendants to satisfy the court by evidence from those who were in the best position to know all the facts and circumstances, that the whole transaction was fair and absolutely free from oppression or wrong."

VI.

The rule that contracts between corporations having a common directorate may be avoided may be invoked by a creditor as well as by the corporations and their stockholders.

This principle has not apparently received extremely numerous applications except in cases where the act in question also constituted a preference—where naturally most of the cases would

arise. The proposition springs unavoidably, however, from the principles of justice and equity that give rise to the broad principles that condemn such contracts. If, as often happens, the one corporation holds all the stock of another and remains in control of the subsidiary corporation, no resistance can, of course, be made by such subsidiary corporation and no reason for such resistance exists. Also there is no minority stockholder to appeal for protection. In such cases, action adverse to the interests of the subsidiary corporation usually has for its motive, if there is a fraudulent motive, the fleecing of the creditors of the subsidiary corporation. To say that in such case only the corporation or a stockholder can act and that a creditor is not in such privity as to give him a standing in a court of justice is to state an absurdity.

And manifestly there can not be, as a broad proposition, any distinction between an unsecured and a secured creditor in this respect. To be sure, an unsecured creditor is completely at the mercy of a dishonest management since he may be entirely deprived of resource for payment of his debt while the secured creditor can in all cases resort to his security but it is plain that the fraudulent acts of a dishonest management might readily deprive the secured creditor of much or all of the value of his security by means often readily available.

There can then be no doubt that the principle is correctly stated when stated broadly—namely—that when a creditor is injured by the acts of directors

which would amount to a fraud upon the corporation and the corporation or its directors do not seek to avoid because they cannot or will not, the creditor may directly invoke the aid of a court of equity in a proper manner by injunction, annulment or recovery, to protect him from the consequences of the fraud. To stop short of this is to affirm that a court of equity cannot, in an important class of cases, discharge its most important function of granting relief from fraud and that plain and undoubted wrongs of flagrant character and of large importance to individuals and to the community have no remedy.

The principle is laid down squarely in 10 Cyc. 791, that contracts between corporations having common directors "are voidable in a proper proceeding taken for that purpose by the corporation, its shareholders *or its creditors.*"

Washburn v. Greene, 133 U. S. 30.

was a case entirely parallel to the case at bar as to the relations of the parties.

It was a foreclosure suit against a railroad company to foreclose a mortgage on all its property to secure the payment of 5500 bonds of $1,000 each. A receiver was at once appointed. The company made no defense but numerous parties, holders of bonds and others with claims of various kinds against the company, with leave of court, intervened in the case and were allowed to prove their respective claims. The controversy resolved itself into a contest for

priority among the various claimants in the distribution of the proceeds of the sale of the mortgaged property thereafter to be made.

The decision of the Supreme Court by Justice Lamar disposes of a number of claims presenting different aspects but the one in which we are particularly interested is one of several claims by Benjamin Richardson, upon 1105 of the bonds.

The board of directors had sent one of their number to Europe to negotiate a sale of bonds and while there he borrowed money for expenses from a Mr. Stevens and pledged to him 50 of the bonds as collateral. These, together with the 1105 bonds, this agent and Stevens deposited in a bank in London with agreement that they should not be delivered to anyone without the joint order of the agent and Stevens. The agent was withdrawn from Europe; the indebtedness due to Stevens was allowed to go to protest and the directors were fearful that Stevens would not only sell the bonds pledged but also the 1105 and thus render nearly valueless the securities held by the directors. To prevent this, Richardson, who was one of the directors, advanced the money, charged it to the company, and received its notes therefor. Subsequently, he obtained judgment upon these notes and attempted to levy on the 1105 bonds and sell them and become the purchaser at a nominal price. He was not only denied any right to the 1105 bonds but the master reported that because of the means employed to obtain a levy on the bonds in question and the sale thereof, Richardson

should have no allowance by way of "equitable salvage" for the money advanced by him to obtain the return of the bonds to the company and the court declared itself in full agreement with the master on this point.

It will be observed that this case is identical with the one at bar in that, against the objections of other bondholders, one in a position of advantage and authority in the company was denied the right to share the proceeds of the mortgage sale upon the basis of bonds obtained by him through a fraudulent use of his position and relations. The case was a foreclosure suit and the immediate proceeding was an intervention by bondholders and neither the corporation nor a stockholder was present invoking the aid of the court for the corporation itself against the fraud.

It is especially significant that no allowance was made to the perpetrator of the fraud for the money which he had expended in connection with the transaction.

A very valuable and instructive case is that of

Sweeney v. Grape Sugar Company, (W. Va.), 4 S. E. 431.

The directors of an insolvent corporation undertook to convey to another corporation having in part the same directors, who were present and participating in the transaction, property to secure a debt to the other corporation. The action was brought by a creditor and it was contended by the defendants that the act was voidable *only* at the instance of the

corporation or its stockholders and that a creditor had no standing to avoid the act of the directors.

On page 436 after reviewing the cases cited by the defendants in support of this contention, the court says:

> "In none of them have I been able to find any principle which would deny to the creditors of an insolvent corporation the right to avoid the transfer of the corporate property made by its directors in violation of their trust and duties or for the benefit of themselves directly or indirectly in a case in which the rights of no innocent third party had intervened and there had been no unreasonable delay."

The court then cites the language of the U. S. Supreme Court in Thomas v. Railroad Company, 109 U. S. 522-24, in which the Supreme Court says that such an act "is voidable at the election of *parties affected by the fraud.*" The West Virginia court then goes on to say:

> "In the case of a corporation which is wholly insolvent and unable to continue its business, neither the corporation itself nor its stockholders have any beneficial interest in its property and, therefore, they cannot be affected by the fraud. In such case, the creditors alone can be affected and they alone have any interest in avoiding the contract."

The cases holding that the directors of a corporation can not take advantage of their relations to

prefer themselves as creditors illustrate a somewhat different phase of the same general principle and a few such cases will be discussed under the next head.

VII.

Directors cannot prefer themselves as creditors to the injury of the other creditors of the corporation.

Lippincott v. Shaw Carriage Co., 25 Fed. 577, (Cir. Ct. Ind. '85; opinion by Justice Woods, p. 585).

Justice Wood says: "The real question therefore is whether or not the preference given or attempted to be given is invalid because Shaw and Robbins who were two of the four directors of the Carriage Company and acting with their associates in ordering the execution of the mortgages were liable as endorsers upon the notes secured thereby. Weight of authority seems to be in support of the affirmative of this proposition; for while it is generally conceded that a corporation, notwithstanding insolvency, continues possessed of a general power of managing its affairs and like natural persons may give preferences by way of payment or security to one creditor or class of creditors over others, yet, in close analogy to the rule which forbids the giving of preferences by individual debtors for the purpose of securing or in such a manner as to secure advantage or benefit to themselves and in manifest accord with the tendency of judicial opinion, as expressed upon consideration of kindred questions, it has been decided in a number of cases that preferences given by insolvent corporations in such a manner as would be of special

benefit to the directors or managing agents, or any of them, will be set aside. This, as it seems to me, is the salutary rule and the only rule which can be administered with uniformity and fairness."

In the case of Howe, Brown & Company v. Sandford Fork and Tool Company, 44 Fed. 231, Justice Woods also wrote the opinion, this case being decided five years later than the Lippincott case. The corporation while still a going concern, though insolvent, gave a mortgage on its property to secure its directors who were liable as endorsers for it to a limited amount. The court held that the mortgage was invalid as to general creditors although it was procured by the directors without any actual fraudulent intent. Justice Woods said:

> "It seems to me enough to say that a sound public policy and a sense of common fairness forbid that the directors or managing agents of a business corporation, when disaster has befallen or threatens the enterprise, shall be permitted to convert their powers of management and their intimate, and it may be, exclusive, knowledge of the corporate affairs into means of self-protection to the harm of the other creditors. They ought not to be competitors in a contest of which they must be the judges. The necessity for this limitation upon the right to give preferences among creditors when asserted by corporations may not have been perceived in earlier times, but the growing importance and variety of modern corporate enterprises and interests I

think will compel its recognition and adoption. The fact in this case that the stockholders authorized the making of the mortgage seems to be immaterial. That action was, it is averred, procured by the directors proposed to be benefited, they themselves being stockholders; and, even if this were not averred, the case would not, I think be essentially different. Whether or not such preferences are fairly given is an impracticable inquiry, because there can be in ordinary cases no means of discovering the truth; and consequently the presumption to the contrary should in every case be conclusive. Concede that it is a question of proof, and that a preference in favor of a director will be deemed valid if fairly given, and it may as well be declared to be a part of the law of corporations that in cases of insolvency debts to directors and liabilities in which they have a special interest must be first discharged. That will be the practical effect, and the examples will multiply of individual enterprises prosecuted under the guise of corporate organization, for the purpose, not only of escaping the ordinary risks of business done in the owner's name, which may be legitimate enough, but of enabling the promoters and managers, when failure comes, to appropriate the remains of the wreck by declaring themselves favored creditors. Besides inconsistency with that equality which equity loves, such favors involve too many possibilities of dishonesty, and successful

> fraud to be tolerated in an enlightened system of jurisprudence."
>
> In Jackson v. Ludeling, 88 U. S. 616, 22 L. Ed. 494;

the complainants were holders of 660 out of 761 bonds of $1,000 each issued by a railroad company. The relief sought was that the mortgage might be declared a valid lien upon all the property described therein and that a sale averred to have been made under it in 1866 to the defendant, Ludeling, and his associates might be set aside; that the defendants be required to account and that the mortgaged property be sold for the benefit of the complainants. This sale was in a proceeding brought by the holder of other bonds of the same issue and was found to have been collusive and fraudulent. The bondholder in question had agreed with directors and officers of the railroad to put through this sale, form a new company and turn the property over to the new company. Justice Strong, in delivering the opinion of the court, said (p. 496):

> "Thus, these directors became avowedly confederates with Gordon to purchase the property and to purchase it for their own benefit; thus, they took a position in which it became their interest that the property should be sold at a low price; that there should be as little competition as possible and that no effort should be made to stay the sale or give any more notice than a formal compliance with the law required. Thus their interests were brought into direct antago-

nism with the interests of the stockholders and bondholders. It is impossible to regard this combination as anything less than a plain violation of their duty, a breach of the trust reposed in them and if not an actual, at least a constructive fraud."

This case bears a very interesting analogy to what was actually sought to be accomplished by the persons who, owning all of the bonds and substantially all of the stock of the Railway Company, which in turn owned nearly all of the stock of the Power Company, brought about a foreclosure of the bonds of the Power Company though not themselves interested therein, planned the purchase thereof by the Railway Company at a nominal figure and sought to hasten the sale and complete the consummation of the scheme at the earliest possible moment.

In Gottlieb v. Miller, 154 Ill. 44; 39 N. E. 992, it was held that an insolvent corporation may confess judgment in favor of bona fide creditors who are not directors or officers even though this results in the appropriation of all the corporate assets to the payment of such creditors; but such a confession in favor of a creditor whose claim is based on an assignment from some of the corporation officers is void. Cites (p. 995) Beach v. Miller, 130 Ill. 162; 22 N. E. 464, to the effect that the directors of an insolvent corporation cannot give away its assets or use them to exonerate themselves to the injury of the other creditors, and that if any of the directors are creditors of the corporation, they cannot secure

any advantage or preference in the payment of their claims at the expense of other creditors. Same doctrine in Roseboom v. Whittaker, 132 Ill. 81, 23 N. E. 339.

In Kittell v. Augusta R. Co., 78 Fed. 855 (Cir. Ct. Southern Dist. N. Y. 1897), a director and creditor of a R. R. Co. caused property to be sold under execution upon a judgment against it for his debt and bought in the property for $100,000 which was less than his debt.

Upon the suit of another creditor, he was required to prorate the $100,000 because being a director, he could not obtain any preference over any other creditor.

VIII.

This is not a case of avoidance or rescission by the corporation or by a party acting by subrogation to the rights of the corporation. The mortgage creditors should be viewed as acting in their own right in objecting upon distribution, to sharing the deficient proceeds of the sale with bonds obtained by fraud and so not valid and outstanding obligations under the mortgage.

The cases in which creditors have been permitted to protect themselves from frauds by directors of corporations, which were also frauds upon the corporations themselves, do not hold that the creditors in such cases are conceived as acting under and by subrogation to the rights of the corporation. On the contrary the inferences fairly to be drawn, both

from the facts of the cases and the language of the courts in deciding them are that the creditors are viewed as directly asserting their own rights as such. In Washburn v. Green, the original suit was by trustees to foreclose their mortgage against a railroad. The company made no defense, but various holders of bonds and others with claims of various kinds intervened. There is no suggestion that the bondholders, of for that matter, the other creditors, were asserting their rights against the fraudulent acts of Richardson who was a director, stockholder, chairman of the executive committee, and Treasurer, under and in subrogation to the rights of the corporation. The obligations of Richardson as a stockholder were also involved in the case and various of the transactions were ones in which the corporation was bound but the creditors were not.

Justice Lamar says (33 Law Ed. 521) : "Undoubtedly his (Richardson's) relation as a director and officer, or as a stockholder of the company does not preclude him from entering into a contract with it or making a loan to it or taking its bonds as collateral security. A court of equity regards such transactions of a party in either of these conditions, not perhaps with distrust but with a large measure of watchful care; and unless satisfied by the proof that the transaction was entered into with good faith with a view to benefiting the company as well as its creditors and not solely with a view to his own benefit, they refuse to lend their aid to its enforcement."

The learned Justice cites with approval the lan-

guage of Mr. Justice Bradley in the case of Graham v. La Crosse and M. R. Co., 102 U. S. 148, 161, "When a corporation becomes insolvent it is so far civilly dead that its property may be administered as a trust fund for the benefit of its stockholders and creditors. A court of equity, at the instance of the proper parties, will then make those funds trust funds which in other circumstances are as much the absolute property of the corporation as any man's property is his." He also quotes the language of Mr. Justice Gray in the case of the Wabash, St. Louis and Pacific Railway Company v. Ham, 114 U. S. 587, 594: "It is also true in the case of a corporation as in that of a natural person that any conveyance of the property of the debtor without authority of law and in fraud of existing creditors, is fraud as against them." After this quotation from Justice Gray, Justice Lamar goes on: "Can the transaction between Richardson and the insolvent corporation, of which he was largely the owner and controller, especially with reference to the claim he is urging in this case, stand the test of the fairness and good faith which, as a director and stockholder, he owed to the corporation itself, its creditors, and bona fide bondholders?"

Nowhere in this case is it suggested that the intervening bondholders in seeking to prevent the payment out of the fund derived from the sale of the property, of bonds obtained by Richardson in violation of the good faith and duty that he owed as a director and controlling factor in the corporation,

were asserting only such rights as the corporation might assert. It seems plain that the bondholders were regarded as being in court strictly in their own right in the suit foreclosing their security and no doubt is intimated as to their legal status to defend by intervention against bonds obtained by means which were a fraud upon them; whether they were a fraud upon the corporation or not.

In Sweeney v. Grape Sugar Company, supra, the action was brought by a creditor to set aside a transfer of property made by one corporation to another having in part the same directors, to secure a debt to the other corporation, the granting corporation being insolvent. The principal defense was that Sweeney had no standing to avoid the transaction but that the act was voidable only at the instance of the corporation or its stockholders. Here the question was directly raised exactly as the Railway Company seeks to raise it in this case. Sweeney brought his independent action as a creditor to avoid the transaction which was doubtless a fraud upon the corporation as well as upon the creditors. The W. Va. court holds squarely against the contention of the defense and goes to the very heart of the question in language already quoted, saying: "In the case of a corporation which is wholly insolvent and unable to continue its business neither the corporation nor its stockholders have any beneficial interest in its property and they therefore cannot be affected by the fraud. In such case creditors alone can be affected and they alone have

any interest in avoiding the contract." In the case at bar not only has the corporation and its stockholders ceased to have any interest in asserting the rights which have been violated for the reason stated by the Virginia court, but for the further and stronger reason that the directors violating those rights are at the same time the creditors benefited by the violation and practically the sole stockholders.

In Lippincott v. Shaw Carriage Company, 25 Fed. 577, supra, a bill was filed by the general creditors to set aside alleged preferential mortgages. A strong effort was made at the trial to show that the debts secured by the mortgages were in whole, or in part, fictitious. The court says (page 585) "the fair and reasonable inference from all the facts is that the indebtedness of the Carriage Company to the Indiana banking company and its assignee, the First National Bank of Indianapolis, was contracted in good faith and consequently the notes made in evidence of it are all unimpeachable obligations." Nowhere in the case is it suggested that these creditors must act as though under and in subrogation to the rights of the corporation and could assert only such rights as the corporation might assert.

In the Sandford Fork and Tool Company case the plaintiffs were general creditors and the suit was brought to set aside a mortgage to secure the directors against their liability as endorsers of the corporation's paper. It was not alleged in the pleadings nor claimed in the argument that there was any actual intent to defraud. The directors in fact

went so far as to have a meeting of the stockholders of the corporation, at which the making of the mortgage was authorized. Manifestly in this case the corporation would have had no standing to avoid the mortgage. Apparently the right of a creditor to obtain directly and without any theory of subrogation, protection from acts which were a fraud upon him was not questioned.

It is asserted in the Bill in Intervention in the case at bar that the exchange of bonds and the release of the Railway Company from its contract to purchase second mortgage bonds was a fraud upon the corporation as well as upon the first mortgage bondholders and this is undoubtedly true. If these directors had been acting solely for the benefit of the corporation, as they would have done if they had not themselves held the second mortgage bonds, they would have employed the resources of the corporation to put it upon a solid foundation by completing its power plant and maintaining and extending its business. What were these resources? They had at least $140,000.00 more due them for second mortgage bonds and there is no intimation that Kissel, Kinnicutt and Company, who were primarily liable, were not entirely responsible. In addition thereto they had the right, as counsel for the Railway Company so vigorously asserted, to issue an additional $825,000.00 of first mortgage bonds. Counsel for the Railway Company substantially admit that these bonds were in 1912 marketable but say that it would have been a fraud upon purchasers to have sold these

bonds without disclosing the full situation of the company. But the company was amply able out of its income to pay the interest on first mortgage bonds and counsel's argument entirely disregards the fact that the proceeds of these bonds would have added to the resources of the company so that default and disaster would in all probability have been prevented. Assuming that the first mortgage bonds would have brought only 80, the $825,000 would have brought $660,000, to which is added the $140,000 due upon second mortgage bonds already contracted for, or a total of $800,000. What would an independent board of directors have done in the faithful discharge of their trust with $800,000 of cash resources at their command? Was it not a fraud upon the company that they should have released the Bankers from their obligation to furnish the company another $140,000 upon a long time obligation; deliberately have given away another $660,000 obtainable upon another long time obligation and in exchange therefor borrow a paltry $250,000 for which they give six months notes with bonds as collateral at two to one? As the learned District Judge so justly said in his opinion (Trans. 139) "that under the circumstances such an agreement was thought by anyone to be in the interests of the Power Company is wholly incredible. I cannot believe that an independent board of directors would have given to it a moment's consideration."

But whether or not the acts of these directors were a fraud upon the corporation we conceive to

be in fact immaterial. As the Supreme Court of West Virginia said after reviewing the cases cited by the defendants in support of the contention that the act complained of was voidable only by the corporation or its stockholders, "In none of them have I been able to find any principle which would deny to the creditors of an insolvent corporation the right to avoid the transfer of the corporate property made by its directors in violation of their trust or duties, or for the benefit of themselves directly or indirectly."

That these acts were a fraud upon the first mortgage bondholders seems almost too plain for controversy but since the main argument of the Railway Company is based upon the contention that it was not such a fraud, we will discuss that question further in our reply to the appellants' argument.

If the theory that the bondholders, if they act at all, must act under and strictly in subrogation to the rights of the corporation be denied, then the avoidance that is sought is manifestly not the avoidance of the corporation but the avoidance of the mortgage creditor and the duty of the interveners in seeking such avoidance is the duty which the law will impose upon them in the circumstances and not the duty which the law would impose upon the corporation.

The duty of one seeking to rescind is plain as a matter of conscience and completely settled as a matter of law. He cannot take the benefits of a transaction and rescind. But is this in any sense a

case of Rescission? Clearly it is not. Rescission is the act of a party to a contract or of someone acting under the right of a party. A third person who is neither party nor privy to a transaction but who is injuriously and wrongfully affected thereby may avoid the consequences of such transaction so far as they affect him and this is the case of creditors who are injured by acts of the directors of a corporation performed in violation of their duty.

One of the principles of rescission, however, applies equally to avoidance—that the party avoiding must restore whatever advantage he obtained by the transaction. The principle is the same, but the application thereof to the corporation on the one hand and to the creditor on the other may lead and usually will lead to an entirely different result. What the corporation got by the whole series of transactions, was, as to the one of September 25, 1912, $110,000 in money in addition to what it already had coming to it on demand from the Railway Company; and as to the transaction of December 27th, it got a debt of $20,000, not liquidated but guaranteed, in other words its old debt was not in the least diminished, but the creditor obtained what was supposed to be additional security. That was what the corporation got but what did the bondholders get? Is there any evidence in the record that they got anything whatever—that is that their mortgage security was in any way enhanced?

The Railway Company had an opportunity upon the intervention to allege and prove if it could, that

the $110,000 went to increase the mortgage security, to pay interest on the first mortgage bonds, which would not otherwise have been paid, or for which funds were not otherwise available or in some way to benefit the bondholders. It did not choose to avail itself of this opportunity but rests solely upon its theory that the transaction by which the company obtained 718 first mortgage bonds were legally defensible, and that the first mortgage bondholders, however much they might be injured in fact were without legal remedy.

We respectfully urge upon the court, and this is the substance of all the errors assigned upon the cross appeal, that in spite of the comprehensive grasp of the somewhat involved questions of fact herein presented, which is evidenced by the opinion of the learned District Judge, the court failed to draw the important distinction which exists between the right which the corporation might assert and the duty imposed upon it in connection therewith and the right which the mortgage creditor asserts after the sale and when the holder of bonds fraudulently obtained presents himself and seeks to share in the proceeds of the sale and the duty imposed upon him. The duty imposed by the judgment of the District Court upon the creditor is exactly the same as the duty which the law would impose upon the corporation if it were rescinding, and we contend that the duty is not the same and in the nature of things cannot be the same upon this state of facts. We insist upon adherence to the principle involved, that

the party seeking to avoid the transactions must restore what he obtained thereby and the application of that principle to the facts. The matter is well illustrated by considering the transaction of December 27, 1912. What did the first mortgage bondholders get by that transaction? The District Court found that the corporation itself got nothing because the things that were given were valueless; but passing that and assigning to the considerations that passed their nominal value, what would the first mortgage bondholders get thereby? Bates and Rogers were general unsecured creditors. Can it be said that these first mortgage creditors in order to resist the final steps in the accomplishment of a fraud upon them must pay as a preferential claim out of the corpus of their mortgage estate the $20,000 and buy back from Bates and Rogers the common and preferred stock of the Railway Company which they obtained as part of the transaction? It would seem that this question answers itself. There can be no real relation between the right of the first mortgage bondholders to resist a division of the proceeds of the sale with these bonds obtained in fraud of them and the payment of a junior and unsecured creditor who has been induced by the corporation or rather by its directors in pursuance of their fraud to accept something else than money in payment of his claim.

Suppose that the $250,000 had been used immediately and in toto to pay an unsecured creditor, or suppose that it had been used to purchase and retire

that quantity of second mortgage bonds, would it not violate every sense of right to say that before the first mortgage bondholders could obtain the disallowance of the first mortgage bonds fraudulently obtained as a part of the transaction they would have to permit the return, out of the corpus of the estate, and as a preference over them, of this $250,000? If that theory is to be successfully asserted then all that is necessary for directors, who may be themselves junior creditors of the corporation, in order to obtain the preference in payment of such junior claims out of the corpus of the estate and prior to the first mortgage bonds, is to perpetuate a fraud upon the first mortgage bondholders as a part of the transaction by which they seek to obtain such preference and the results are insured, for the first mortgage bondholders in order to avoid the effects of the fraud will have to submit to the preference.

If it be argued that the Railway Company is entitled to recover the $110,000 not merely because the corporation obtained that much additional money in the transaction of September 25th, but because the Railway Company is entitled to have the security for which it contracted, mainly $440,000 of first mortgage bonds, we reply that that is not the latest contract which it made with reference to the matter. When it made that agreement of September 25th, for first mortgage bonds as collateral at two for one, it evidently intended that to be only a temporary arrangement, for in the same instrument

it contracted for an exchange under which the same bonds would become its absolute property. This exchange it made, strictly of its own volition and strictly of its own volition it substituted therefor, as collateral, second mortgage bonds. That is the position in which it voluntarily placed itself, and having undertaken a fraudulent proceeding whereby it hoped to become the absolute owner of the bonds in question and thereby voluntarily deprived itself of those bonds as collateral and having substituted other collateral, why should it complain if it is left to enforce its claim against the collateral which it has itself selected?

Courts are not particularly tender to protect wrong doers from the consequences of their own wrongs. Equally well established among equitable principles with the one that requires restoration in case of rescission or avoidance is the one that equity will not protect the wrong doer against the consequences of his own wrong. Frequently the wrong doer is in fact protected by the necessity that the court shall not permit the other party to profit thereby; but where it does not appear that the other party will profit, the court will certainly not concern itself with the trouble in which the wrong doer finds himself and particularly will it not assess an innocent party in order that the wrong doer may not suffer.

We refer only to the case of Washburn v. Green, supra, upon this point. Richardson, the defrauding director, had paid out a large sum of money in con-

nection with the acts by which he obtained the bonds which were dis-allowed. In that connection the master said (33 Law Ed. 523) "it is a general rule that fraud or any gross misconduct upon the part of the salvors in connection with the property saved will work a forfeiture of the salvage and the evidence in this case, with reference to the means employed to obtain a levy upon the bonds in question and the sale thereof fully justifies us in the conclusion which I have reached, that no allowance should be made to Richardson by way of 'equitable salvage' for the moneys advanced by him to obtain the return of the bonds to the company." To this Justice Lamar adds "we fully agree with what is said by the master and do not deem it necessary or essential to add anything further on that point."

REPLY TO APPELLANTS' ARGUMENT.

I.

The substance of the Railway Company's theory of the case is that since the 718 bonds were properly and legally certified by the trustee, under the terms of the first mortgage, no question can thereafter be raised by the holders of other first mortgage bonds regarding the disposition made of them by the corporation. Counsel goes so far as to intimate that had the first mortgage bonds, after such certification, been embezzled by the directors, it would have been no affair of the other first mortgage bondholders so long as the company did not complain.

The fundamental error of this theory is that it assumes that the creditor of an insolvent corporation has no right with respect to prejudicial transactions by its officers and directors that the corporation itself would not have. It need scarcely be argued in this court that this assumption is wholly mistaken. The District Court found that this corporation was insolvent on September 25, 1912. It is not disputed by appellants that the corporation was insolvent. Appellants frankly admit that on September 25th, the directors realized that the company could not go on and that the steps taken on September 25th and thereafter were taken in view of this condition of insolvency and for the purpose of protecting the interests of the Railway Company as a creditor.

The principle that creditors of a corporation, secured or unsecured, can have set aside preferences created by its officers and directors in their own favor when the corporation was insolvent, without any regard to what the corporation might or might not do or have a right to do, is too well established to need discussion.

The Railway Company seems to argue however that a mortgage creditor is precluded from taking steps which will manifestly be open to other classes of creditors because he has a written contract defining what security he shall have and if the letter of that contract has been complied with, with reference to the issue of obligations under his security, preferences and frauds though they may attack and

destroy the value of his security or his ability to realize thereon can not be complained of. The argument would prove too much. Every creditor has presumably what his contract calls for. When a merchant sells goods on open account and extends credit upon the general responsibility of the corporation, he has what his contract calls for—the general obligation of the company for which its assets are liable. If one lends a corporation money and takes its note without mortgage or collateral, his contract defines his rights. If he has collateral pledged for payment of his note, he has two contracts, the note and the pledge defining his rights but the existence of these contracts does not require the creditor to be subject to fraud and preference whereby the assets that might be available to pay his debt are reduced or misappropriated.

It cannot be argued that the first mortgage bondholders are not injured by the fraudulent issue of the 718 bonds. It is stipulated that the Power Company's property will not sell for enough to pay the first mortgage indebtedness in full, therefore the participation of the 718 bonds in the distribution, by exactly the amount payable to them, reduces the amount which may be paid to the holders of valid bonds under the same issue. Counsel declares that this is *damnum absque injuria*, and this reduction in the sum available to pay the bona fide first mortgage bondholders would be without legal wrong if the bonds in question had been issued in good faith for the benefit of the corporation without preference

while it was a solvent concern. Nothing is better established in the law than that what directors may do in good faith with the assets of a solvent concern, they cannot do in bad faith with the assets of an insolvent concern and for the purpose of benefiting and preferring themselves at the expense of other creditors whether secured or unsecured.

This portion of the argument of appellants disregards the stipulation which they entered into in open court with respect to the character and status of this litigation. It was agreed and is declared in the decree (Trans. 163) that the proceeding shall be regarded as being had after sale and upon distribution and the application of the Railway to share in the proceeds of the sale as the holder of the 718 bonds. Is it not clear that this eliminated any question (if such question could otherwise exist) as to whether the corporation is complainant or as to what the corporation might or might not have a right to do? If, being so presented, the bonds were obtained by fraud, actual or constructive, or if they constitute a preference in favor of the Railway which the common directors of the corporation could not lawfully create when the corporation was insolvent, then they certainly can not be paid out of the proceeds of the sale if the result will be to prevent the bona fide first mortgage bondholders from receiving payment *pro tanto*.

That the transaction does constitute a preference need perhaps not be argued. These people held second mortgage bonds. There was about to be a de-

fault in interest and a foreclosure of the first mortgage bonds. It is agreed that the property will not bring enough to pay the first mortgage bonds in full. It follows, therefore, that the second mortgage bonds were worthless and for this creditor to take advantage of its control of the debtor to issue to itself first mortgage bonds in payment of the junior obligations which it held while the company was insolvent and bankruptcy was contemplated, is as clear and outrageous a case of preference as could possibly be found.

Since appellants insist so strongly upon the force and effect of the contract contained in the terms of the first mortgage, and that such effect precludes the bondholders from any remedy against fraud or preference working to their prejudice, it should be observed that this transaction was in clear violation of the purposes and intent of the first mortgage contract.

The trust deed sets out very specifically the purpose for which the proceeds of the first mortgage bonds may be used. 500 6% bonds were forthwith certified and sold for the corporate purposes; 550 were reserved for refunding underlying divisional bonds; 2000 were set aside for building the Ox Bow plant; the remainder (of which the 718 bonds are part) were to be used for the purpose of purchasing property and additions thereto. Nothing here is said about using them, or any of them, to refund a junior mortgage.

The second or consolidated mortgage on the other hand specifically provides for the refunding of the first mortgage and $7,000,000 of the $10,000,000 authorized, or so much thereof as might be required, were reserved for the purpose of such refunding. The consolidated mortgage was a long term obligation, the principal of which would not be due for many years. The first mortgage fell due earlier and began to fall due serially in 1915. That the company should, after being able to market these long term bonds secured by the second mortgage, use shorter term bonds under the first mortgage with which to refund them, certainly cannot be conceived to be within either the letter or the spirit of the first mortgage contract; this without regarding for the moment, any question of fraud or preference, and considering only the "contract" upon which appellants so strongly insist, and upon this extraordinary application of which they must in fact rely for any theory of defense.

The objection that there is nothing in the record to show the status of the interveners as creditors when the acts complained of were committed was not made in the District Court. It is entirely without substance. It was stipulated in the trial that the $2,494,000 of bonds certified under the first mortgage were outstanding prior to September 25th, 1912, and that the total amount of first mortgage bonds in the Treasury on September 25th plus certifications subsequent thereto and prior to April 1st, was the $718,000 in question and that the total

amount certified after April 1st, was the $107,000. The bonds represented by the intervenors are therefore necessarily a part of the 2,494 outstanding on September 25, 1912.

Of the cases cited by counsel for the Railway Company, three contain language in the opinions appearing to hold against the right of a creditor to maintain an action based upon charges of fraud by the directors of a corporation where the immediate sufferers are ostensibly the corporation and its stockholders. These are O'Connor Mining Company v. Coosa Furnace Company, 98 Ala. 614; U. S. v. Union Pacific Railroad Company, 98 U. S., 596; 25 Law. Ed. 143; and Van Weel v. Winston, 115 U. S. 228; 29 Law. Ed. 384.

In the Coosa Furnace case, the bill was by a general creditor. There had been transactions between the Furnace Company and some of its own stockholders and directors and two other corporations having the same boards of directors. Members of a family named Crawford owned a controlling interest in all of the corporations and were on its boards and all the corporations were controlled by them and their adherents.

Upon examination, the case is seen not to hold in any way different from the principles announced hereinabove. It declares the absolute right of the corporation or its stockholders to have contracts between corporations in such a case absolutely avoided regardless of the question of advantage or detriment to either company—which goes farther as to the

stockholder than counsel for the interveners do, but the court says that a creditor has not the right absolutely to so avoid regardless of the question of advantage or disadvantage but that his right depends upon the fraudulent character of the acts. This is unquestionably sound, but the court says that the fact that the directors are common is of itself a suspicious circumstance and is the ground for the most careful inquiry. In the Coosa Furnace case, there was no direct discussion by the court as to where the burden of establishing the good faith and beneficial character of the act would rest, but in fact the defendants assumed that burden and according to the court showed fully and in great detail all the facts which, to the mind of the court, established its absolute good faith and its beneficial character. The acts particularly attacked were a mortgage and a deed of conveyance. The court found that the mortgage was given for money actually loaned and that the deed was for property which was paid for by the purchaser at its full value.

The court also found that the corporation was not insolvent.

The case of the United States v. the Union Pacific Railroad Company is not calculated to throw much light upon the question presented in the case at bar. The proceeding was under a special act of Congress, directing the bringing of the action, prescribing its character and creating special jurisdiction for the purpose. The court expressly found that no debt was then due from the Railroad to the United States

and that collateral matters raised by the suit had already been heard in two other cases, one of which was all ready for decision and the other of which was progressing, and that it did not appear that any rights of the United States as a creditor were being jeopardized.

It is, of course, true as a general proposition that creditors cannot through a court of equity substitute their judgment for the judgment of the directors of a corporation as to how the affairs of such corporation shall be managed, but the case at bar is far removed from any such situation. We have here in fact a case where all of the objections that have been raised in any of the cases where creditors have intervened are eliminated. We have the actual collapse and insolvency of the corporation following immediately upon the fraudulent acts of the directors. We have the frank admission that the directors of the parent or controlling corporation anticipated the collapse of the subsidiary and acted in view thereof and for the purpose of protecting as far as they could the interest of the controlling corporation. We have a foreclosure of a mortgage by which these interveners are secured and we have the controlling corporation seeking in such foreclosure to enforce and realize upon the advantage which by virtue of its control, it seized on the eve and in anticipation of that collapse.

Van Weel v. Winston was a case where a bondholder was in fact seeking to recover from the President of a railroad corporation, partly upon the the-

ory of a misappropriation of funds by the president and partly upon a trust fund theory which throw no light upon the case at bar and which we will not discuss. The facts, the relations of the parties, the theory of the action and the remedy sought are so entirely different from the case at bar that we cannot see that the case assists this court in determining the present case. The language of the court that the money was the money of the corporation and not of the bondholders and could be disposed of as it saw fit was doubtless entirely correct and appropriate language in dealing with the questions there presented without throwing any light on our case.

It is not disputed that the Power Company had the legal right to have the additional bonds certified under the first mortgage though no one acquainted with all the facts will believe that it was intended at the time of the execution of the second mortgage to have additional certifications under the first. Nor do we dispute the right of the directors to dispose of them in good faith while the company is solvent. What we do say is that if the company is insolvent in fact and legal insolvency is contemplated, the directors cannot use these bonds or any other assets or resources of the corporation to prefer themselves to the prejudice of other creditors; that the acts constituting a preference are a gross and palpable fraud upon the corporation and everybody interested therein merely adds another unimpeachable ground for equitable interference.

II.

We will discuss as briefly as possible the arguments of the Railway Company by which it seeks to justify the transactions of September 25th and December 27th. The District Court which had before it not only the record presented upon this appeal but the entire foreclosure record and the trial of a great many other collateral issues has (Trans. 139-140) described the character of the transaction of September 25th convincingly and conclusively. As disputing the inferences of bad faith and to show that the $140,000 still due from the Railway Company upon second mortgage bonds was not sufficient, for the needs of the company, counsel refers to the statement of the company's manager (Trans. 426-429) to show that $342,988 was needed for the period ending December 31, 1912, and that the cash available was $139,808, leaving an estimated cash deficit of $203,180. An examination of the statement, however, shows that $212,562 of these requirements were for extensions to the system and not for meeting existing or current obligations, and certainly additional capital investment could only be justified by a going concern and not by one that was about to fail. Of the $250,000 which was so needed, a substantial part was not advanced until after January 1st and of that which was provided prior to Jan. 1st, $79,500 (being the interest on $1,325,000 of bonds) was paid by the Railway Company to itself for interest which according to its own showing was not earned.

All the circumstances attending the meeting of September 25th are consistent with the conception of a fraudulent scheme on the part of the directors of the Idaho-Oregon, who were also members of the Railway syndicate. The transactions of Sept. 25th were certainly of a most extraordinary character. None of the members who were not in the Railway syndicate had any intimation in advance of what was to be done. Even the two Mainlands who were expected to execute the contract were not informed in advance that such a contract was to be presented. There were no proposals, no discussion, no exchange of views. The company's New York counsel, who was Fuller's personal attorney, had prepared the minutes in full in advance, including even the record of a unanimous vote "except the vote of Mr. Fuller which was not cast because of his interest in the contract." Not one of the western members in fact voted for the resolution. It was adopted exclusively by the vote of the directors who were members of the Railway syndicate.

What was the effect? It released the Railway Company from taking any more bonds under the contract of 1911 and it abstracted from the treasury of the Idaho-Oregon every scrap of paper then in the treasury or prospectively possible to be obtained which had any value under the circumstances or which might have been in any way marketable for the benefit of and for the purposes of the company and transferred it bodily to these directors.

That there was no good faith, but on the other

hand a contemptuous disregard for decent appearances is found in the fact that there is no attempt to measure the consideration involved in the exchange but it was for all the bonds that could be gotten hold of, however many or few they might be, up to a maximum which was placed large enough to insure a complete clean-up.

It is noteworthy also that Fuller said to Sinclair Mainland when questioned after the meeting as to the reason for the proceeding that "it would put them in much better shape to have those bonds in case of trouble in the Idaho-Oregon."

The transaction of December 27th has even less color of justification. Assuming that it was desirable to get rid of the Bates and Rogers contract, it is clear from the testimony of William Mainland that Rogers stood ready to take first mortgage bonds for the $20,000 at their market price. Mainland stated this to Fuller, who said he wouldn't give him any first mortgage bonds but would give him seconds with the Railway guaranty. All pretense of necessity for this transaction thus disappears and the advisability of giving 25 second mortgage bonds and $500,000 additional first mortgage bonds in order to get them guaranteed, instead of giving, say 25 of their first mortgage bonds outright in the first place, can hardly be a subject for discussion. There were indeed good reasons from the Railway point of view for wishing to get rid of Bates and Rogers. They intended to take over the Idaho-Oregon property at a foreclosure sale and they had their own

plans about future power developments and they wished to have no conflicts growing out of Bates and Rogers being on the ground with perhaps a large claim and the right to a mechanic's lien. But the plan that was adopted for paying $20,000 of the settlement price, was clearly a mere device to give some color of consideration for another exchange of bonds; they having doubtless in the meantime discovered that they could obtain certifications for more than the first $500,000.

The later steps in the plans of the Railway group must however be considered in order to throw into the full light the character of the proceedings of September 25 and December 27, 1912.

Although they authorized the first exchange on September 25 none were made until January and in the meantime they paid themselves the interest on the 718 second mortgage bonds. In January and early February they made the exchange. On February 24 the entire Railway syndicate group scuttled off the directorate of the Idaho-Oregon (Trans. 349). Even this proceeding was probably invalid since each resignation left the board without a quorum to transact business and therefore without the ability to elect a successor.

In March Mr. Fuller formed his "protective committee" and under date of March 26th sent out the plan of re-organization and a circular letter which explained to the bondholders of the Idaho-Oregon how helpless they were and invited these small scattered bondholders to deposit their bonds with this

protective committee containing some of the best known names in Wall Street. The deposit agreement and the circular letter carefully refrained from stating that the persons constituting the "protective committee" were for the most part members of the Railway Syndicate and so in fact the prospective buyers. This act of obtaining possession and control of the bonds to be foreclosed, by the very persons who at the same time owned and controlled the corporation which was to purchase without disclosing that fact, was utterly fraudulent, and, practiced as it was by great financiers upon 500 small scattered and helpless bondholders, was as contemptible as it was dishonest.

The bondholders did not come along fast enough and so the "protective committee" sent for the brokers who had sold the bonds; kept them in New York for ten days at the expense of the committee, and finally "convinced" a part of them by paying them commissions for "advice" to their customers.

Having obtained possession of the requisite two-thirds of the bonds (counting the 718 bonds as theirs) they caused the trustee to bring foreclosure as soon as the 60 days of grace had expired, although the preamble of their deposit agreement recited that the agreement was for the purpose of avoiding foreclosure. They took their evidence before the return day of the summons and on the return day presented a decree ready for delivery and sought an early sale.

Now what would the result have been of a sale at that time? Observe the interview of the Idaho coun-

sel of the company in a Boise paper given out upon the filing of the bill to foreclose. (Trans. 51). The public and the court were to be given to understand that it was a "friendly suit" instituted in order to affect a re-organization made necessary by the expansion of the property, the plans including a consolidation with the Railway Company. The property would have been purchased at the sale for a nominal sum and the Idaho-Oregon first mortgage bondholders would have had their election to take the Railway second mortgage bonds or practically nothing. Reducing the Idaho-Oregon first mortgage bondholders to a junior position in the consolidation meant simply transferring bodily the entire income of the Idaho-Oregon property to the holders of the Railway bonds, to-wit: the syndicate. If there were any fragment left at any providential future time, the tricked and defrauded Idaho-Oregon bondholders might have it.

The scheme was conceived in its entirety prior to September 25, 1912. It not only reeks with fraud but it is essentially sinister and corrupt and if it had been or shall be successful both deceit and oppression will have been its instruments.

III.

The argument of appellants under this head seems a strange abandonment of the theory of literal application of the mortgage contract upon which the previous portion of the argument is based. When considering the right of the first mortgage bondholders to prevent a fraudulent preference and the dilution

of their security by the unlawful acts of the directors, the first mortgage bondholders are held, as it were, to be estopped from urging any equitable considerations but to be held and confined by the strict letter of their mortgage contract which it was earnestly asserted had been complied with. They are not to be permitted to inquire whether the acts complained of were fraudulent or not. Admitting they were fraudulent and admitting that the bondholders will suffer the loss of part of their money thereby, they are nevertheless to have no relief because, it is said, it is not in their contract.

But when the woeful plight of the second mortgage bondholders who, with their eyes open, bought a second mortgage bond (and received $4,000,000 of stock as a bonus and control of the company thereby) is considered, they are held to have an equitable right to subrogation under the first mortgage because the proceeds of their bonds have added to the mortgaged property and the second mortgage bonds no longer look good to them. The facts are of course that there should have been no more bonds issued under the first mortgage and it was the act of these same people who are complaining that any were certified, and they caused them to be certified only for purposes of fraud. If they had left the situation alone the first mortgage bondholders would have had their security and the second mortgage bondholders would have their junior security upon whatever equity there existed, whether created by money derived from the second mortgage bonds or

otherwise. That is exactly what each party had contracted for and what each party was entitled to have. The theory that one can contract for a second mortgage security and thereafter upon the foreclosure of the first mortgage plead to be "subrogated" under the first mortgage and share the security therewith, borders on the fantastic.

IV.

Assuming that the exchange of bonds was invalid, the Railway Company argues that the Railway Company should have restored to it the $250,000 and interest and whatever the Power Company got in connection with the Bates and Rogers transaction; what that is, or how it is to be measured, counsel does not seem to be able to define, but seem to be satisfied with an additional $20,000.

It is unnecessary to discuss the principle of rescission and the obligations which it imposes. It is necessary only to consider whether this is a case of rescission, i. e., whether it is the corporation acting or someone acting in the right of the corporation, and what the party seeking to avoid got and therefore what he ought to restore. The questions then are:

1. Can the bondholders act in the premises only under and by subrogation to the rights of the corporation and is the corporation rescinding through the act and agency of the bondholders; or are the bondholders, standing in the office of the special master to receive distribution, objecting strictly in

their own right to sharing the proceeds of the sale with the bonds fraudulently obtained, such fraud constituting also a preference?

2. If the corporation is rescinding what did the corporation get and what is it bound to restore?

3. If it is not a case of rescission by the corporation but a case of the bondholders asserting in their own right an objection to sharing the proceeds of the sale with fraudulent bonds, what did they get and what are they bound to restore?

We have already made clear our views upon the first question and cannot perhaps enlarge upon them to advantage. The main suit is a suit to foreclose these bonds. The bondholders are necessarily parties, either by representation or in their own persons. They are in their own right and not in any possible sense through the corporation or its rights, to which they are adverse. The controversy respects their bonds and other bonds which seek to share with them. The court has by its decree defined the position and status of the parties, to which definition all parties assented, namely that the Railway Company is the actor, presenting certain bonds which it obtained by the methods disclosed and seeking to share in the proceeds of the sale. For the purpose of the present discussion it is conceded that the bonds were obtained by fraudulent means and are invalid and not outstanding obligations under the mortgage; that if enforced they would also constitute an unlawful preference in favor of the corporation which got them, is also perfectly clear, and, it will be observed,

has not been disputed by appellants in their brief. The bondholders, although for the most weighty reasons raising this question before the sale, are, by stipulation, regarded as interposing a defense to the claim that the fraudulent bonds shall share in the deficient proceeds of the sale. How they can, at that time and place, asserting that right, be regarded as doing so and entitled to do so only under and in subrogation to such rights as the corporation might have in the premises, present counsel are unable to perceive. That creditors of any class whatever may avoid unlawful preferences affecting them, and may resist in their own right and for their own protection, frauds of corporations and directors which injure them, is established by any number of adjudications, seems rarely to have been questioned and is clear in principle.

With reference to the second question, the appellants contend that the corporation got $250,000 through the transaction of September 25, 1912, which these bondholders should be bound to restore. The District Court found expressly (Trans. 159) that all the transactions which were adopted or directed by the meeting of September 25, were connected and interdependent, each constituting a consideration for the other. This is completely evident from the record itself, of that meeting, which was carefully prepared in advance by the company's attorney. The agreement (Exhibit "A," Trans. 112) recites the obligation of the Bankers to take the other $175,000 of second mortgage bonds and their will-

ingness to do so, but offer "in consideration of the Bankers being released from their obligation to purchase said $175,000 par value of said bonds, to procure for the Oregon Company upon the terms thereinafter expressed the said sum of $250,000." The terms thereinafter expressed were that the Idaho-Oregon Company should give its notes for the $250,000 due in six months with collateral at two to one and should exchange $500,000 of bonds. The three elements are therefore indissolubly connected; the release of the Bankers, the loaning of the $250,000, and the exchange of $500,000 of bonds. Clearly if the transaction is to be rescinded it must be rescinded as a whole and since the contract says that the Bankers "are ready and willing to purchase at the said contract price said $175,000 first value of said bonds" and the right of immediate demand by the Idaho-Oregon for the $140,000 thus to be realized is fully recognized, certainly that immediate demand is automatically off-set against the $250,000, and therefore it is plain that what the Idaho-Oregon Company got by that transaction, which it did not have or would not have otherwise, was $110,000.00.

So if it is a question of what the corporation ought to do and if the bondholders are bound to do what the corporation would be bound to do, then the bondholders must restore $110,000.

Strictly speaking, that is not quite the status since the Railway Company would be entitled to recover the $110,000 only according to the methods prescribed in that same transaction. By the con-

tract they were to have as collateral not a lump sum of $500,000 but they were to advance immediately $100,000 and the balance thereof as requested within six months, "to be secured by an amount of the Oregon Company's first and refunding mortgage gold bonds bearing interest at the rate of five per cent per annum, equal at their face value to twice the amount of such loan."

If then, by means of this transaction, the Railway Company parted with only $110,000 more than it was already bound to part with, the terms of their contract would be complied with by allowing them to retain $220,000 of first mortgage bonds as collateral to the $110,000.

Hendee, the Secretary-Treasurer, who seems to have been the one to physically handle all the paper in the transaction, testifies that $440,000 was actually deposited as such collateral and that is the amount which the District Court allows the Railway Company to retain as security. The question has become academic since either the $440,000 or $220,000 will be sufficient security. The view of the District Court apparently was that they should be amply secured and allowed to retain what they got without regard to the fact that the real debt was less than half the amount nominally loaned. We think the correct view is, upon the theory of rescission through the corporation, that the Railway Company would be entitled to retain $220,000 of first mortgage bonds as collateral.

The appellants, however, dispute the proposition that the Railway Company and the Bankers are the same in interest as respects the obligation to take an additional $175,000 of second mortgage bonds. The District Judge who has had this case before him in many other aspects in addition to this one for a year and a half had no doubt about this and an examination of this record will in our judgment equally satisfy this court.

Fuller was the partner of Kissel, Kinnicutt and Company who was running this thing and who was the manager of the syndicate. He testified (Trans. 195) "subsequently a syndicate was formed to take over the holdings of Kissel, Kinnicutt and Company in the Power Company and in other property which they had acquired and which later became the property of the Railway Company." Notice the sequence: First the contract by Kissel, Kinnicutt and Company, next the forming of a syndicate and next the transfer of the interests thus acquired, including the holdings of Kissel, Kinnicutt and Company in the Power Company, to the Railway Company. The Railway Company was organized in the latter part of 1911 and since in the latter part of 1912 it already had out $6,500,000.00 of bonds, it cannot be doubted that immediately upon its organization it took over these properties, including this interest in the Idaho-Oregon. This was in fact what the Railway Company was organized for. Fuller goes on; "the syndicate found itself owning a large interest in the Idaho-Oregon Company, and also, for the

benefit of the Idaho-Oregon Company and for the benefit of the entire situation it had built up here an absolutely independent and what was going to be a profitable enterprise consisting of a power plant, and a large interurban and urban street railway system" (referring to the properties of the Railway Company) "and they thereafter, as the Idaho-Oregon Company was in no position financially to take over the property of the Railway Company, and the syndicate had two interests, thought it would be wise to turn over all of their interests in the Idaho-Oregon Company to the Railway Company which they did, taking securities of the same class from the Idaho Railway for securities of the Idaho-Oregon Company, which they turned in to the Railway Company."

On September 27, two days after the meeting of September 25, there was a meeting of the Executive Committee of the Idaho-Oregon (Trans. 250) at which a four-party agreement between Kissel, Kinnicutt and Company, the Idaho-Oregon, the Mainlands, and the Railway Company was adopted, which recognized and reduced to writing the existing status among the parties. This contract recites:

"WHEREAS the Bankers did on the second day of April, 1912, enter into an agreement with the Railway Company for the transfer to the said Railway Company of various of the properties mentioned in the preceding recital," etc., and * * *

"WHEREAS it is desired by the parties hereto to recognize the existing status of the parties and

to mutually release and discharge certain of the obligations contained in the said Syndicate Contract and to confirm others;

NOW, THEREFORE, THIS AGREEMENT WITNESSETH:"

"First: That paragraph Fifth of the said Syndicate Contract wherein and whereby the Bankers are granted an option to purchase from the Oregon Company for cash at eighty per cent. of their face value and accrued interest, the whole or any part of the Consolidated Bonds of said Oregon Company and prescribing the terms and conditions of said option and the whole of said Paragraph is hereby confirmed and continued in force and said option is by the Bankers transferred and assigned to the Railway Company and the Railway Company and the Oregon Company each recognize and confirm said assignment; PROVIDED that the provision of said Fifth Paragraph which grants said option on condition that the Bankers purchase $1,500,000.00 face value of said Consolidated Bonds is hereby modified to the extent that the Oregon Company accepts the purchase of $1,325,000 face value of said bonds heretofore made by the Bankers as hereinbefore stated as full and complete satisfaction of their obligation to purchase said $1,500,000.00 face value of said Consolidated Bonds;

Second: The Sixth Paragraph of said Syndicate Contract relating to the retirement of prior lien bonds on the properties of the Oregon Company and providing for the issuance of Consolidated Bonds to

retire said prior lien bonds, and the purchase of said Consolidated Bonds by the Bankers at eighty per cent of the face value thereof is hereby confirmed and continued in force; save and except that the Railway Company is hereby substituted to the rights and liabilities of the Bankers in respect to the covenants of said paragraph to the same extent as if the Railway Company were expressly named therein and the Bankers are released from all obligations thereunder and provided that the Oregon Company shall on demand of the Railway Company in lieu of tendering sufficient Consolidated Bonds at eighty, to retire said prior lien bonds, procure to be issued and delivered to the Railway Company at ninety, First and Refunding Mortgage Five Per Cent Bonds of the Oregon Company to the extent that said First and Refunding Mortgage Five Per Cent Bonds are available for such purposes and Consolidated Bonds at 80 for the balance for which said First and Refunding Mortgage Bonds are not available."

It seems beyond dispute from these facts that the Railway Company had succeeded to all the rights and obligations of the Bankers under the Syndicate Agreement as early as April 2, 1912. This agreement of September 27th made two days after the meeting of September 25th, is expressly declared to recognize the existing status—evidently a status so far as the purchase of these bonds is concerned, dating at least from April 2. The substitution of the Railway Company for the Bankers certainly would not have taken place just as the smash was in pro-

cess. It had been contemplated from the beginning (as will be seen from an examination of the Syndicate Contract of September 19, 1911, Trans. 168) and was undoubtedly always in effect so far as the obligations of the parties were concerned and became legally in effect as soon as the Railway Company was organized; and the contract of April 2, like the contract of September 27, did not originate or establish the relations but merely recognized the relations existing in the pool.

It is nearly inconceivable that Kissel, Kinnicutt and Company separate and distinct, and as an independent obligation, would have gone on buying Idaho-Oregon bonds and transferring them as fast as acquired to the Railway, without the Railway Company being under any obligations to take care of the balance of the contract.

With reference to the Bates and Rogers deal and the further exchange predicated thereon, it apparently is conceded that the stock of the Railway Company is eliminated from consideration. The District Court was of the opinion (Trans. 143) that the Railway Company was itself insolvent at the time of the agreement.

Counsel still argue, however, that the Railway Company has incurred a liability for $20,000 and should therefore be allowed $20,000 out of the corpus of the Idaho-Oregon estate as a condition of avoiding the fraudulent exchange. It is to be observed that the agreement of the Railway Company (Trans. 402) is to re-purchase from Bates and Rogers at

their option the 25 second mortgage bonds of the Power Company or any part thereof after 18 months at the price of $800 per bond, but if the option was not exercised within 60 days after the expiration of the said 18 months, the Railway Company was released from any further obligation. The contract is dated November 29, 1912. There is no evidence in the record that Bates and Rogers have ever exercised the option and if they had it is perfectly clear that it would cost the Railway Company nothing. The claim of Bates and Rogers in such case would be an unsecured claim against the Railway Company and the Railway Company has admitted its insolvency.

At the most if the Railway Company were solvent the liability in question is only a contingent liability and could not be made the basis of a recovery of $20,000 or any other sum. It must first not only become an actual liability but have been paid.

In its opinion on this branch of the case the District Court (Trans. 144) says: "From the testimony and the surrounding circumstances no doubt is left in my mind that the Power Company could have made settlement directly with Bates and Rogers with its first mortgage bonds at a comparatively small discount; and that the devious course was adopted not upon their demand or for the interests of the Power Company, or from any necessity therefor, but for the sole purpose of furnishing a pretext of getting the first mortgage bonds out of the treasury of the Power Company and into the hands of the Railway Company, and for the interest alone of

those by whom the latter company was dominated."

V.

We will endeavor to be brief in the discussion of the alleged errors in the admission of evidence. The whole record and the matters which now will influence the minds of this court in coming to its conclusions seem to us to demonstrate:

1. That the condition of the Railway Company in the latter part of 1912, which it was sought to show by the introduction of portions of its reports, was competent and material. This seems also to be established by the fact that counsel for the Railway Company subsequently stipulated regarding the Receivership and the insolvency of the Railway at a later time.

2. That the condition of the Idaho-Oregon Company was manifestly material in arriving at a just conclusion as to whether the Directors of the Railway Company acted in good faith or not in the transactions of Sept. 25 and Dec. 27, 1912.

3. That evidence of the marketability and the market price of the Idaho-Oregon first mortgage bonds at dates as nearly as possible approximating the dates of these transactions was also material and competent as bearing upon the same question of good faith.

4. That the operating history of the Power Company for the years immediately preceding the control, and for the one year that had expired after the

control of the Railway Company was material and competent as bearing upon the question of solvency or insolvency, which itself was material and as bearing upon the question of good faith or of fraudulent intent in the dealings of the Railway Directors as Directors of the Power Company.

The foregoing are the matters admitted over the objections of the Railway Company and for which the appellants assign error.

5. That the pretended record of an Executive Committee meeting on December 27, 1912, ought not to have been admitted as any evidence of authority under which the 278 bonds were exchanged. There were five members present at that meeting of the Executive Committee. It is not disputed that one was held. Two of those members, the Mainlands, testified that they have no recollection of any such things having transpired at the meeting and that they were unaware until about the time their depositions were taken that two exchanges of $500,000 each had been authorized instead of one. It is true that William Mainland appears to have signed an agreement respecting this second exchange but this is not necessarily inconsistent with the veracity of his testimony. Doubtless the contract was prepared and handed to him for signature, with some casual explanation. Without careful examination he might easily have supposed, since the amounts were identical (and also because he probably knew there was not another $500,000 of bonds available), that the same $500,000 was referred to and that it was con-

nected up with the Bates and Rogers transaction to furnish an additional consideration to bolster it up.

The three other syndicate members of the Executive Committee and Mr. Wickes, the attorney who testified that he prepared the minutes, were all on the stand and were readily available to appellants counsel at any time as witnesses. The three members were not interrogated with reference to this transaction either before or after the Mainlands testified that to the best of their recollection there was no such transaction. Mr. Wickes was interrogated particularly with reference to this meeting and these minutes. The court may be interested to observe that he was not asked whether the transaction disputed by the Mainlands was had or not and does not say that the minutes are a correct record of what took place.

6. The later dealings of the Railway Company in carrying on their alleged plan to obtain the property without adequate payment and thus to defeat the just claims of the bondholders seems to us competent in view of the allegations of the Bill in Intervention and therefore the offer was made to prove their proposal to bid $1,500,000 in December and their actual offer of $1,000,000 in March.

7. The exclusion of the circular and plan of the New York committee of March 26, 1913, and the revised plan of May 1, 1913, (assignment of cross error X) have become immaterial since they appear in the record as exhibits to the answer of the State Bank to the Bill in Intervention.

8. Cross error XI is assigned upon the exclusion of a part of the deposition of Mr. Fuller (Trans. 468-472) in which, under cross-examination, he explained the efforts made by the New York committee to obtain the deposit of bonds including the bringing of the brokers to New York at the expense of the committee, who were present, and the representations made by the brokers to their customers. Appellees believe that this evidence was material and competent upon the question of good faith of the Railway Directors in dealing with the Idaho-Oregon affairs and as tending to establish the theory of the complete plan, continuously carried out, to obtain the property of the Idaho-Oregon Company for the Railway Company without adequate consideration.

9. Cross error XII is based upon the exclusion of a part of the deposition of Fuller (Trans. 473-475) in which upon cross examination Fuller admitted the payment of commissions to brokers in connection with their assistance in obtaining the deposit of the bonds of their customers with the New York committee. Appellees urge that this evidence also is competent and material as bearing upon the question of good faith and tending to establish the existence of a complete and continuous scheme having for its purpose the confiscation of the Idaho-Oregon Company.

SUMMARY.

1. The Railway Company was in complete control of the Power Company for almost a year prior to September 25, 1912, having obtained nearly all of the Power Company's stock, and by exercising the voting power of that stock had elected its own board of directors to be throughout the board of directors of the Power Company, which directors elected the President, Vice-President, Secretary, Manager and other principal officers and agents of the Railway Company to exercise the same functions in the Power Company.

2. On September 25, 1912, the Power Company was insolvent and was known to be so by the Railway Company and the common directors and the proceedings of September 25, 1912, were taken in the light of that knowledge.

3. The enterprise of the Railway Company had been unprofitable and it had created an enormous indebtedness with fixed charges greatly exceeding the income applicable thereto and the whole enterprise was in grave peril on this account.

4. The transactions of September 25 were carried through by a Board all of whom were interested in the transactions and would be favorably affected by the action alleged to have been taken. Eight members out of eleven were present, three of whom were further disqualified by being directly parties to the contract which was authorized. This left five or less than a quorum of the board who under

any theory were entitled to act. The fundamental action was adopted by an affirmative vote of four persons. The record found in the record book is false as to the vote.

Therefore the fundamental action of September 25 was not a corporate act.

5. The pretended action of September 25 was not taken in good faith for the benefit of the Power Company but was solely for the benefit of the Railway Company as a creditor, was of no benefit to the Power Company but on the contrary was a step in a scheme to destroy it, and was fraudulent and corrupt.

6. The pretended acts of September 25 were a fraud upon the Power Company as a corporation and was in addition thereto a direct fraud upon its creditors other than the Railway Company, against which the creditors can defend in their own right.

7. The acts of September 25 were an unlawful and fraudulent preference of the Railway Company and its directors who owned its securities, and that preference, in case the Power Company property should not sell for enough to meet all of its bonds, prejudices the first mortgage bondholders, and to the extent to which they are prejudiced they can interpose a successful defense against the preference.

8. The alleged proceedings of December 27 by which an additional exchange of bonds was author-

ized, was not a corporate act, there being no competent evidence that any such proceeding was had.

9. The syndicate directors of the Railway Company having determined in their own interests to get control of and foreclose the first mortgage bonds, buy in the property for a nominal sum, and pay off the Power Company's first mortgage bondholders with securities junior to the securities owned by them, adopted the devices of September 25th and December 27, 1912, as a part of the scheme and for the purpose of getting rid of their second mortgage bonds which in the proceeding would become worthless, sharing the property with the first mortgage bondholders and obtaining a foothold under the first mortgage which would assist them in controlling and foreclosing the first mortgage and dominating all the proceedings connected therewith.

10. The whole scheme is fraudulent and the decree of the District Court in setting it aside should be affirmed.

11. The District Court erred however in not distinguishing between the duty imposed upon the bondholders under the status declared and assented to in the last paragraph of the decree and the duty of the corporation if it were rescinding.

12. The duty of the corporation or a stockholder thereof, rescinding, would be to repay $110,000 and interest. In the absence of evidence that the bondholders received any benefit from this $110,000 or any part thereof or that the transaction added any-

thing whatever to the value or security of the mortgage estate, no such duty is imposed upon the bondholders.

The decree of the Circuit Court should be modified by directing the exchange of the 718 bonds without condition. If the Railway Company finds itself in an unfortunate position because thereof, it is placed in that position by its own fraud from which it is neither the duty of the first mortgage bondholders nor the court to relieve it.

Respectfully submitted,

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